

AR82



Annual Report  
**2006**





## PETRO-REEF RESOURCES LTD.

### ANNUAL REPORT 2006

| CONTENTS:                            |               | PAGE |
|--------------------------------------|---------------|------|
| Management's Discussion and Analysis | Form 51-102F1 | 1    |
| Reserves Report                      | Form 51-101F1 | 33   |
| Financial Statements with Notes      | Audited       | 53   |

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis for Petro-Reef Resources Ltd. should be read in conjunction with the audited financial statements and notes, contained in the annual report for 2006 and are based on information available to April 05, 2007. Additional information regarding Petro-Reef is available in the updated Annual Information Form which has been filed electronically, at the same time as this report, on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com) or on Petro-Reef's website at [www.petro-reef.ca](http://www.petro-reef.ca).

### ABBREVIATIONS

|        |   |                |                             |
|--------|---|----------------|-----------------------------|
| ARTC   | Alberta Royalty Tax Credit                  | GJs/d          | Gigajoules per day          |
| Bbl    | barrel                                      | M <sup>3</sup> | cubic meters                |
| Bbls   | barrels                                     | Mbbls          | thousands of barrels        |
| Bcf    | billion cubic feet                          | Mcf            | thousand cubic feet         |
| BOE    | barrel of oil equivalent<br>(1 BOE = 6 Mcf) | Mcf/d          | thousand cubic feet per day |
| Bbls/d | Barrels per day                             | MMbbls         | millions of barrels         |
| BOPD   | Barrels of oil per day                      | MMcf           | million cubic feet          |
| FNR    | Future net revenue                          | MMcf/d         | million cubic feet per day  |
| GJ     | Gigajoule                                   | NGLs           | natural gas liquids         |
|        |   | NPV            | net present value           |

**NOTE:** In this report all currency values are in Canadian Dollars.



## **FORWARD-LOOKING STATEMENTS**

Some of the statements contained herein (including without limitation, financial and business prospects and financial outlooks) may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Corporation assumes no obligation to update or review them to reflect new events or circumstances.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Corporation's general expectations concerning this industry is based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Corporation believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Corporation is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

### **NOTE:**

Petro-Reef cautions that "cash flow from operations" and "netbacks" do not have standardized meanings prescribed by Canadian generally accepted accounting principles and are therefore unlikely to be comparable to similar measures presented by other issuers. Management believes "cash flow from operations," defined as cash provided by operations before changes in non-cash working capital, is a useful indicator of the Company's ability to fund future capital expenditures, Petro-Reef calculates netbacks as net dollars per barrel after Crown Royalties, operating expenses and general and administrative expenses.

Reference is made to barrels of oil equivalent (BOE). Barrels of oil equivalent may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a BOE conversion ratio for natural gas of 6 Mcf: 1 Bbl has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

## THE YEAR 2006 IN REVIEW

Petro-Reef Resources Ltd. (TSX-V: PER), a Calgary based crude oil and natural gas exploration and production company with producing properties in Alberta, Canada, capitalized on its drilling success and strong commodity prices to earn \$65,060 on cash flow from operations of \$3,557,432 in 2006. This compares to earning of \$248,714 on cash flow from operations of \$2,007,713 in 2005.

Total production for 2006 was 165,471 barrels of oil equivalent (BOE), an increase of 150% over the production for 2005 of 66,305 BOE. This is equivalent to 455 BOE/d in 2006 and 182 BOE/d in 2005.

Petro-Reef's production in 2006 came from two core properties, Alexander/Qui Barre and Peavey/Morinville, both located near Edmonton, Alberta. Alexander/Qui Barre produced about 88% of total production for about 89% of the revenue while Peavey/Morinville, produced about 11% of total production for about 10% of the revenue. The remaining production came from minor working interest and royalty properties. About 96% of the production was natural gas with about 4% as crude oil and natural gas liquids.

Activities during the year included drilling, completions, tie-ins, and work-overs/re-completions. Additional 2-D and 3-D seismic data were acquired, processed and interpreted.

The company continues to use the following exploration criteria on each prospect to assure high profitability and rate of return on capital investment:

- 1) Each exploration prospect must exhibit
  - a) Potential for a minimum of three hydrocarbon zones.
  - b) Potential for:
    - (i) 10:1 profit to capital risk ratio
    - (ii) a minimum of 30% rate of return on capital invested
    - (iii) minimum life of 15 years
- 2) Both 2-D and 3-D seismic are used to identify and confirm potential drilling locations using state-of-the-art technology.

Management uses cash flow from operations per share to analyze operating performance. Cash flow from operations per share does not have any standardized meaning prescribed by Canadian Generally Accepted Accounting Principles ("GAAP") and therefore it may not be comparable with the calculation of similar measures for other entities.



**Highlights of Financial and Operations Results for Fiscal Years 2004-2005-2006.**  
**THREE-YEAR REVIEW AND PERCENT CHANGE FROM 2005-2006**

|  | 2004        | 2005         | 2006         | % Changes 2005 to 2006 |
|--|-------------|--------------|--------------|------------------------|
| <b>FINANCIAL</b>                                       |             |              |              |                        |
| Crude Oil and Natural Gas Revenue                      |             |              |              |                        |
| Net of royalties and ARTC                              | \$2,162,656 | \$3,224,567  | \$5,749,891  | +78                    |
| Cash Flow from Operations                              | 1,065,076   | 2,007,713    | \$3,557,432  | +77                    |
| Net (Loss) Earnings from Operations                    | (\$542,087) | \$248,714    | \$65,060     | -80                    |
| Net (Loss) Earnings per Share                          | (\$0.03)    | \$0.01       | \$0.00       | -                      |
| Capital Expenditures                                   | \$1,148,725 | \$2,374,843  | \$7,888,288  | +232                   |
| Total Assets   | \$8,691,850 | \$10,462,289 | \$15,056,446 | +44                    |
| Bank Balance (Loan)                                    | (\$700,000) | \$397,904    | (\$376,613)  | -                      |
| Shareholder's Equity                                   | \$4,021,268 | \$6,029,968  | \$7,919,194  | +31                    |
| Common Shares Outstanding                              |             |              |              |                        |
| End of Period  | 17,738,937  | 21,438,924   | 23,685,291   | +10                    |
| Weighted Average                                       | 17,701,232  | 18,994,641   | 22,313,869   | +17                    |
| <b>OPERATIONS</b>                                      |             |              |              |                        |
| Average Production                                     |             |              |              |                        |
| Crude Oil and NGLs (Bbls/day)                          | 13          | 2            | 25           | +1,150                 |
| Natural Gas (Mcf/day)                                  | 954         | 1,080        | 2,615        | +142                   |
| Total BOE per (day 6Mcf: 1bbl)                         | 172         | 182          | 455          | +150                   |
| Finding & Development Cost per BOE P <sup>(1)P</sup>   | \$9.61      | \$5.27       | 7.15         | +37                    |
| Netbacks (\$ per BOE) P <sup>(3)P</sup>                | \$23.70     | \$34.90      | 22.93        | -34                    |
| Reserve Replacement Ratio                              | 0.66        | 2.41         | 7.14         |                        |
| Average Selling Price                                  |             |              |              |                        |
| Crude Oil (\$ per BOE)                                 | \$45.25     | 59.97        | 64.15        | +7                     |
| Natural Gas (\$ per BOE)                               | \$37.02     | 57.43        | 36.90        | -36                    |
| NGL (\$ per BOE)                                       | \$48.25     | 55.50        | 57.20        | +3                     |
| <b>Reserves (Proved plus Probable)</b>                 |             |              |              |                        |
| Crude Oil and NGLs (Bbls)                              | 16,300      | 1,000        | 95,000       | +9,400                 |
| Natural Gas (MMcf)                                     | 2,569       | 3,754        | 7,505        | +100                   |
| Total BOE  | 444,467     | 503,500      | 1,345,833    | +167                   |
| <b>Present Value of Reserves (MS) P<sup>(2)P</sup></b> |             |              |              |                        |
| Undiscounted before Taxes                              | \$12,848    | \$26,119     | \$36,499     | +39                    |
| Discounted before Taxes at 10%                         | \$9,294     | \$18,639     | \$23,857     | +28                    |
| Reserve Life Index (P+P)                               | 32.6 yrs    | 22.5 yrs     | 33.9         | +51                    |
| Reserve Life Index (P)                                 | 18.3 yrs    | 19.3 yrs     | 33.4         | +73                    |

(1) After revisions due to NI51-101.

(2) Using constant prices and costs.

(3) Using a conversion of 6,000 cubic feet of natural gas for one barrel of oil equivalent.

(4) Crude oil sales were non-operated and reported with total oil and gas sales combined.

Netbacks are calculated by subtracting royalty expenses and operating expenses from revenue per barrel of oil equivalent. These calculations are before Alberta Royalty Tax Credits.

Petro-Reef's reserve replacement ratio for 2006 using proved reserves, was 7.14 to 1, an increase of 196% over the comparative number for 2005. Reserve replacement ratio for a given year is calculated by dividing total reserves at the end of the year by the total reserves at the beginning of the year. The reserve life index for proven plus probable reserves increased by 47% from 22.5 years to 33.9 years.

Operating costs for 2006 averaged about \$125,247 per month, an increase from an average of about \$63,000 per month for 2005. The increased costs were a result of costs of fieldwork required to produce one new well drilled in June 2006 and the re-completion, and reworking of more wells than in 2005.

Net general and administration costs had a modest increase to approximately \$96,513 per month in 2006 from approximately \$34,514 per month in 2005 and approximately \$33,048 per month in 2004. Except for some minor increases, the highest costs since 2003 were due to additional reporting requirements, legal, accounting, engineering and related third party charges.

Capital expenditures for 2006 were \$7,888,288 compared with \$2,374,843 in 2005, an increase of 232%.

The net present value of proved plus probable reserves at constant prices and costs (undiscounted), before income tax, for 2006 is \$36,499,000. This is a 40% increase from \$26,119,000 in 2005. The comparable numbers at a 10% discount of future net revenues are \$23,857,000 for 2006, and \$18,639,000 for 2005, a 30% increase.

There are no long-term financial liabilities and there have been no dividends declared.

At year end the bank loan plus cheques drawn in excess of bank was \$376,613.

Revenues fluctuated during 2006 because of changes in volumes of product produced and with changes in product price. Because Petro-Reef produces more than 96% natural gas, natural gas prices fluctuations had more impact than prices for crude oil. The following table shows natural gas prices received by Petro-Reef for 2004, 2005 and 2006 by month and by quarter.



**Product Price for Natural Gas (\$ per Gigajoule)**

Years: 2004-2005-2006

| Month of:                  | \$ Price Per GJ<br>Year 2004 | \$ Price Per GJ<br>Year 2005 | \$ Price Per GJ<br>Year 2006 |
|----------------------------|------------------------------|------------------------------|------------------------------|
| January                    | 6.659749                     | 6.233800                     | 8.13720                      |
| February                   | 5.757239                     | 6.260490                     | 6.918360                     |
| March                      | 5.881507                     | 7.000700                     | 6.229420                     |
|                            |                              |                              |                              |
| Average Price per Quarter: | 6.099498                     | 6.498330                     | 7.094967                     |

|                            |          |          |          |
|----------------------------|----------|----------|----------|
| April                      | 6.274938 | 7.347800 | 6.272940 |
| May                        | 6.950898 | 6.562240 | 5.269670 |
| June                       | 6.564088 | 7.052828 | 5.532040 |
|                            |          |          |          |
| Average Price per Quarter: | 6.596645 | 6.987623 | 5.69150  |

|                            |          |           |          |
|----------------------------|----------|-----------|----------|
| July                       | 6.479279 | 7.058280  | 5.385630 |
| August                     | 5.724071 | 8.727350  | 6.069370 |
| September                  | 5.326431 | 10.478270 | 4.412930 |
|                            |          |           |          |
| Average Price per Quarter: | 5.843260 | 8.754633  | 5.289310 |

|                            |           |           |          |
|----------------------------|-----------|-----------|----------|
| October                    | 6.170750  | 11.725960 | 5.557470 |
| November                   | 5.878970  | 8.837250  | 7.308530 |
| December                   | 6.382450  | 11.414247 | 6.669890 |
|                            |           |           |          |
| Average Price per Quarter: | 6.1440570 | 10.659152 | 6.511963 |

|                        |      |      |      |
|------------------------|------|------|------|
| Average Price for Year | 6.17 | 8.22 | 6.15 |
|------------------------|------|------|------|

**Note:** 1 gigajoule = 1.054615 thousand cubic feet

Crude oil sales prior to May 2006 were insignificant and came from non Petro-Reef operated wells. From May through December 3,382 barrels of crude oil were produced from a well in the Alexander area. The revenue for the sale of the oil was \$216,946 for an average price of \$64.15



# **2004 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE**

| (0)     | (1)       | (2)      | (3)           | (4)             | (5)            | (6)               | (7)               | (8)              | (9)           |
|---------|-----------|----------|---------------|-----------------|----------------|-------------------|-------------------|------------------|---------------|
| Month   | BOE       | BOE/Day  | REVENUE<br>\$ | ROYALTIES<br>\$ | EXPENSES<br>\$ | (3)-(4)-(5)<br>\$ | NETBACK<br>\$/BOE | NET<br>G&A<br>\$ | (6)-(8)<br>\$ |
| JAN     | 2,825.17  | 91.13    | 137,355.77    | 12,709.29       | 43,284.05      | 81,362.43         | 28.80             | 18,837.22        | 62,525.21     |
| FEB     | 3,641.01  | 125.55   | 133,496.03    | 13,771.13       | 42,704.64      | 77,020.29         | 21.15             | 29,074.94        | 47,945.35     |
| MAR     | 3,417.61  | 110.25   | 127,525.48    | 14,289.24       | 48,280.94      | 64,955.30         | 19.01             | 15,259.65        | 49,695.65     |
| APR     | 5,770.79  | 192.36   | 233,092.98    | 15,498.94       | 61,999.80      | 155,594.24        | 29.96             | 45,816.05        | 109,778.19    |
| MAY     | 3,992.75  | 128.80   | 180,722.54    | 15,395.47       | 43,759.92      | 121,567.15        | 30.45             | 16,384.28        | 105,182.87    |
| JUNE    | 3,466.69  | 115.56   | 145,289.96    | 13,848.70       | 48,927.05      | 82,514.21         | 23.80             | 39,837.73        | 42,676.48     |
| JUL     | 3,715.14  | 119.84   | 152,414.21    | 13,674.49       | 37,332.76      | 101,406.96        | 27.30             | 35,132.52        | 66,274.44     |
| AUG     | 3,905.77  | 125.99   | 149,652.72    | 23,671.87       | 80,493.17      | 45,487.68         | 11.65             | 12,289.45        | 33,198.23     |
| SEP     | 8,257.77  | 275.26   | 281,082.07    | 62,951.32       | 58,432.77      | 159,647.98        | 19.33             | 25,906.62        | 133,741.36    |
| OCT     | 8,447.87  | 272.51   | 342,544.17    | 71,917.97       | 55,010.69      | 215,615.51        | 25.52             | 25,410.16        | 190,205.35    |
| NOV     | 8,070.05  | 269.00   | 320,631.26    | 85,299.54       | 52,887.68      | 182,444.04        | 22.61             | 24,348.22        | 158,095.82    |
| DEC     | 7,425.08  | 239.52   | 318,982.17    | 91,470.06       | 43,000.63      | 184,511.48        | 24.85             | 108,273.16       | 76,238.32     |
| ARTC    |           |          | 253,789.39    |                 |                | 1,472,127.27      |                   |                  | 1,075,557.27  |
| Total   | 62,935.71 | 2,065.77 | 2,600,177.39  | 434,498.02      | 616,164.70     | 1,548,515.27      | 284.43            | 396,570.00       | 1,151,945.27  |
| Average | 5,244.64  | 172.15   | 216,681.45    | 36,208.17       | 51,347.06      | 129,042.94        | 23.70             | 33,047.50        | 95,995.44     |

**NOTES:**

- Column (3) Product sales and royalty income
- Column (6) Net revenue after royalties and operating expenses
- Column (9) Net profit before bank debt
- ARTC Alberta Royalty Tax Credit

**2005 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE WITHIN ACCOUNTING**

| (0)          | (1)       | (2)     | (3)           | (4)             | (5)            | (6)               | (7)               | (8)              | (9)           |
|--------------|-----------|---------|---------------|-----------------|----------------|-------------------|-------------------|------------------|---------------|
| Month        | BOE       | BOE/Day | REVENUE<br>\$ | ROYALTIES<br>\$ | EXPENSES<br>\$ | (3)-(4)-(5)<br>\$ | NETBACK<br>\$/BOE | NET<br>G&A<br>\$ | (6)-(8)<br>\$ |
| JAN          | 7,367.51  | 237.66  | 310,711.42    | 70,680.79       | 64,643.59      | 175,387.04        | 23.81             | 22,325.27        | 153,061.77    |
| FEB          | 6,773.74  | 241.92  | 288,734.03    | 60,640.03       | 59,529.17      | 168,564.83        | 24.89             | 22,844.63        | 145,720.20    |
| MAR          | 7,191.67  | 231.99  | 343,926.08    | 68,857.01       | 60,307.95      | 214,761.12        | 29.86             | 19,485.05        | 195,276.07    |
| APR          | 5,609.23  | 186.97  | 283,212.95    | 59,962.41       | 54,385.15      | 168,865.39        | 30.10             | 10,822.37        | 158,043.02    |
| MAY          | 4,970.16  | 160.33  | 222,242.41    | 44,181.74       | 38,870.44      | 139,190.23        | 28.01             | 20,272.25        | 118,917.98    |
| JUNE         | 2,986.45  | 99.55   | 140,777.82    | 19,392.12       | 75,196.28      | 46,189.42         | 15.47             | 15,554.30        | 30,635.12     |
| JUL          | 3,095.79  | 99.86   | 179,998.70    | 31,696.59       | 62,789.33      | 85,512.78         | 27.62             | 87,883.82        | (2,371.04)    |
| AUG          | 3,901.35  | 125.85  | 229,811.06    | 37,950.26       | 59,278.69      | 132,582.11        | 33.98             | 32,723.56        | 99,858.55     |
| SEP          | 3,825.79  | 127.53  | 266,590.43    | 45,765.99       | 63,607.76      | 157,216.68        | 41.09             | 31,017.72        | 126,198.96    |
| OCT          | 3,107.61  | 100.25  | 245,614.59    | 40,079.51       | 49,190.15      | 156,344.93        | 50.31             | 10,397.90        | 145,947.03    |
| NOV          | 3,418.72  | 113.96  | 202,850.89    | 39,535.41       | 46,393.77      | 116,921.71        | 34.20             | 28,003.25        | 88,918.46     |
| DEC          | 14,141.01 | 456.16  | 1,086,446.35  | 253,558.01      | 119,574.69     | 713,313.59        | 50.44             | 112,837.66       | 600,475.93    |
| Total        | 66,389.03 | 181.84  | 3,800,916.73  | 772,299.93      | 753,766.97     | 2,274,849.83      | 34.27             | 414,167.78       | 1,860,682.05  |
| Other Months | (84.00)   | (0.23)  | (2,644.73)    | (45,699.28)     | 3,936.03       | 39,118.52         | 0.63              | -                | -             |
| Total        | 66,305.03 | -       | 3,798,272.00  | 726,600.65      | 757,703.00     | 2,313,968.35      | -                 | -                | -             |
| ARTC         | -         | -       | 152,896.00    | -               | -              | 152,896.00        | -                 | -                | 152,896.00    |
| Total        | -         | -       | 3,951,168.00  | -               | -              | 2,466,864.35      | -                 | -                | 2,013,578.05  |
| Average      | 5,525.42  | 181.61  | 329,264.00    | 60,550.05       | 63,141.92      | 205,572.03        | 34.90             | 34,513.98        | 167,798.17    |

Column (3) Product sales and royalty income  
Column (6) Net revenue after royalties and operating expenses  
Column (9) Net profit before bank debt  
ARTC Alberta Royalty Tax Credit



2006 PRODUCTION AND REVENUE SUMMARY BY PRODUCTION DATE

|                                       | (1)<br>BOE | (2)<br>BOE /<br>Day | (3)<br>REVENUE<br>\$ | (4)<br>ROYALTIES<br>\$ | (5)<br>EXPENSES<br>\$ | (6)<br>(3)-(4)-(5)<br>\$ | (7)<br>NET<br>BACK<br>\$/BOE | (8)<br>NET G + A<br>\$ | (9)<br>(6)-(8)<br>\$ |
|---------------------------------------|------------|---------------------|----------------------|------------------------|-----------------------|--------------------------|------------------------------|------------------------|----------------------|
| JAN                                   | 18,750     | 605                 | 1,030,866            | 328,676                | 142,097               | 560,093                  | 30.04                        | 20,865                 | 539,228              |
| FEB                                   | 16,658     | 595                 | 778,359              | 215,596                | 140,129               | 422,634                  | 25.79                        | 103,284                | 319,350              |
| MAR                                   | 18,091     | 584                 | 761,372              | 207,405                | 106,892               | 447,075                  | 24.35                        | 31,016                 | 416,059              |
| APR                                   | 16,172     | 539                 | 706,282              | 180,048                | 108,919               | 417,315                  | 25.46                        | 119,622                | 297,693              |
| MAY                                   | 16,424     | 530                 | 606,923              | 157,342                | 135,131               | 314,451                  | 18.53                        | 81,268                 | 233,182              |
| JUNE                                  | 15,931     | 531                 | 624,749              | 138,578                | 135,586               | 350,586                  | 21.41                        | 146,966                | 203,620              |
| JUL                                   | 11,831     | 382                 | 471,832              | 99,319                 | 119,279               | 253,234                  | 22.22                        | 83,721                 | 169,513              |
| AUG                                   | 9,816      | 317                 | 416,339              | 90,931                 | 127,899               | 197,509                  | 21.92                        | 134,073                | 63,436               |
| SEP                                   | 9,485      | 316                 | 303,147              | 60,446                 | 113,231               | 129,469                  | 13.54                        | 46,494                 | 82,975               |
| OCT                                   | 9,014      | 291                 | 341,579              | 56,717                 | 131,277               | 153,585                  | 16.09                        | 73,721                 | 79,864               |
| NOV                                   | 11,405     | 380                 | 559,747              | 99,835                 | 116,841               | 343,071                  | 31.03                        | 119,134                | 223,937              |
| DEC                                   | 12,144     | 393                 | 555,399              | 138,913                | 125,687               | 290,799                  | 24.75                        | 197,997                | 92,802               |
| Total Before<br>the Following<br>ARTC | 165,721    | 5,463               | 7,156,594            | 1,773,806              | 1,502,968             | 3,879,820                | 275                          | 1,158,160              | 2,721,660            |
| Total                                 | 165,721    | 5,463               | 367,103              | -                      | -                     | 367,103                  | -                            | -                      | 367,103              |
| Average                               | 13,810     | 454                 | 626,975              | 147,817                | 125,247               | 4,246,923                | 275                          | 1,158,160              | 3,088,763            |

|        |     |  |
|--------|-----|--|
| Column | (3) | Product sales and royalty income                   |
| Column | (6) | Net revenue after royalties and operating expenses |
| Column | (9) | Net profit before bank debt                        |
| ARTC   |     | Alberta Royalty Tax Credit                         |

## PROPERTY REVIEW

Petro-Reef Resources Ltd. operated the drilling of ten development wells and four exploration wells in the Alexander/Qui Barre area in 2006. Of these, ten wells were completed as natural gas wells, one was completed as a crude oil well and three were dry and abandoned, for a success ratio of 79%. The Peavey/Morinville area saw no new drilling activity, is still primarily outside operated and although still part of the larger core area for Petro-Reef, represents a much smaller percentage of the company's production and revenue stream. Shareholders were kept up to date on the progress of field activity with news releases whenever significant new information became available.

A news release dated March 20, 2006 provided details on the renewed drilling program by Petro-Reef as follows:

As part of the renewed program, Petro-Reef plans to drill five more wells offsetting a successful natural gas discovery in October 2005. In October, the Company announced that it had completed a new natural gas well at 12-28 in its core area of Alexander/Qui Barre. The well tested at 11.91 million cubic feet per day (mmcf/d), equivalent to 1,958 barrels of oil equivalent per day (boe/d). The well was placed on production in December 2005 and has been producing at a stabilized rate of 4.18 mmcf/d (697 boe/d). Petro-Reef's interest in the well is 84% before payout of a 400% penalty.

As a result of the success of the 12-28 well drilled in October 2005, Petro-Reef has increased its interest in the Alexander/Qui Barre area by 20%, taking its interest in an additional fifteen wells to a range of between 54% and 64% on 9,271 gross acres (4,966 net acres) for an average of 51%.

A second well drilled as part of the program in November 2005 was anticipated to produce at 66 bo/d net. This well has since been suspended due to water production. Petro-Reef has a 44% interest in the well. Early production from the well was not included in Petro-Reef's 2005 forecasts.

A subsequent news release dated May 09, 2006 further updated the shareholders as follows:

Petro-Reef Resources Ltd. is in the process of completing a five-well drilling program offsetting its October 2005 natural gas discovery in Alexander, Alberta. Based on the initial success of the program announced on March 20, 2006, Petro-Reef plans to drill a sixth well in the area within two weeks. Petro-Reef expects to drill up to 25 wells (11.94 net) in 2006 (including the previously announced five well drilling program), rig availability permitting.

Petro-Reef's gas discovery at 12-28 in the Alexander area of Alberta has continued to produce at 4.18 million cubic feet of natural gas per day (697 barrels of oil equivalent per day) since it was put on production in December. The company's interest in the well is 84% (585 boe/d) until revenue from the well reaches 400% of drilling costs. Petro-Reef's interest then reverts to 34%.

The first well offsetting the 12-28 natural gas discovery was drilled at 12-33. Based on well logs, Petro-Reef believes it has hit the same natural gas zone as the 12-28 and identified a previously unknown oil zone. The company has set production casing and expects to complete the well within two weeks. Petro-Reef has a 54% interest in the well.



The second well in the five-well program was drilled at 6-1. Production casing was set and the well has been perforated, fractured and swabbed. Based on the encouraging results of the swab test, Petro-Reef has started a 30-day production test. Petro-Reef's interest in the well is 44%.

The third well in the program was drilled at 5-31. The company has identified a pay zone containing both oil and natural gas. Petro-Reef anticipates starting a 30-day production test on the well in the oil zone within the next week. Petro-Reef has a 64% interest in the well.

The fourth well was drilled at 13-21. The well was deemed to be uneconomic and has been abandoned. The company had a 54% interest in the well.

The fifth well of the program is to be drilled in the next two weeks at 11-27 where Petro-Reef has a 54% working interest.

And again on June 14, 2006 the following information was sent by news release which stated in part that:

The October 2005 natural gas discovery at 12-28 has continued to produce at approximately 4.18 million cubic feet of natural gas per day (697 barrels of oil equivalent per day) since it was put on production in December 2005. The company's interest in the well is 84% (585 BOE/d) until revenue from the well reaches 400% of drilling and completion costs plus 200% of equipping and tie-in costs. Petro-Reef's interest then reverts to 34%. Based on current production levels and commodity prices, this reversion is anticipated to occur in August 2006. The 12-28 is the only well in Petro-Reef's 2006 drilling program that features a working interest agreement of this kind.

The first well offsetting the 12-28 natural gas discovery was drilled about two kilometers north at 12-33. The company set production casing and has completed the same zone as 12-28 with an initial flowing production test of 525 Mcf/d and a crude oil rate of 48 barrels per day. Petro-Reef has 54% interest in the well. Net to Petro-Reef is 73 BOE/d.

The second well in the five-well program was a re-entry at 6-1. The production casing was perforated and fracture stimulated. The well was placed on production May 2, 2006 and is producing crude oil at a rate of 38 barrels per day with 80 Mcf/d of natural gas. Petro-Reef has a 44% interest in the well. Net to Petro-Reef is 22 BOE/d.

The third well in the program was drilled at 5-31. The company has identified a pay zone with 123 feet of gross natural gas and crude oil pay. The well was perforated and fractured in the oil zone and was placed on stream as a flowing oil well on May 19, 2006. After three weeks of production the well is flowing at 42 barrels of crude oil per day with 592 Mcf/d of natural gas. Petro-Reef has a 64% interest in the well. Net to Petro-Reef is 90 BOE/d.

The fourth well was drilled at 13-21. As announced on May 9, 2006, the well was deemed to be uneconomic and has been abandoned.

The fifth well was drilled at 11-27, two kilometers east of the discovery at 12-28. Based on well logs, Petro-Reef has identified four potential crude oil and/or natural gas zones. The zone that is producing at 12-28 was drill stem tested at 11-27 with a maximum wellhead absolute open flow (AOF) potential rate of 7.312 MMcf/d.

A second zone up-hole in the wellbore was drill stem tested with a maximum wellhead AOF potential rate of 2.464 MMcf/d. The combined AOF for the two zones was 9.776 MMcf/d (1,620 BOE/d). Petro-Reef has a 54% interest in the well. A production test will be conducted in the next two weeks to determine the production rate.

Both the first well at 12-33 and the fifth well at 11-27 are anticipated to be placed on stream by August 1, 2006. The other two successful wells have been placed on stream.

After the initial five-well drilling program Petro-Reef drilled an additional well at 1-31 and re-entered a well at 10-33. Both wells have been cased and will be production tested in the next two to three weeks.

Rig availability permitting, the company expects to drill up to 25 wells (11.94 net) in 2006, including the wells that have been drilled to date and the six wells that will be licensed for drilling in the next two to six weeks.

Continued drilling success was announced in a news release letter on July 27, 2006.

Petro-Reef's October 2005 natural gas discovery at 12-28 is currently producing at 2.16 million cubic feet of natural gas per day (306 barrels of oil equivalent per day net to Petro-Reef). Based on current production levels and commodity prices, Petro-Reef expects to retain its 84% interest in the well until October 2006. At that time, Petro-Reef's interest will revert to 34% when revenue from the well reaches 400% of drilling and completion costs plus 200% of equipping and tie-in costs. As stated on June 14, 2006, the 12-28 well is the only well in Petro-Reef's drilling program that features a working interest agreement of this kind.

Production tests on two offsetting wells in the same zone as the 12-28 are now complete at 12-33 (two kilometres north) and 11-27 (two kilometres east). Based on the results, the 12-33 and 11-27 are expected to produce 2.5 MMcf/d of natural gas plus 30 barrels per day of oil (447 BOE/d). The company's interest in these two wells is 54%, or 241 BOE/d. Petro-Reef expects to tie in these wells and bring them on stream by August 10, 2006. Based on the success of the offsetting wells, the company plans to drill two more wells in the same reservoir at the end of August and beginning of September 2006 at 8-29 (one kilometre southwest) and 14-20 (2.1 kilometres southwest).

A re-entry well announced on June 14, 2006 at 6-1 has been on stream for 83 days and continues to produce 35 to 38 barrels of oil per day with 80 Mcf/d of natural gas. At Petro-Reef's 44% interest, net production is 22 BOE/d. By early August 2006, the company plans to re-enter a well at 11-14 (3.7 kilometres to the northwest) to conduct a production test in the same oil zone. Petro-Reef's interest in the 11-14 is 50%.

A well announced at 5-31 on June 14, 2006 continued to flow as an oil well until July 24, 2006 with production rates after 65 days of 377 Mcf/d of natural gas and 35 barrels per day of crude oil. With a 64% interest in the well, net production to Petro-Reef has been 63 BOE/d. On July 25, 2006, the company started remedial work to complete and place the up-hole zone on stream. This is expected to occur within two weeks. If required, the well will be placed back on stream with a pump.



An offset well was re-entered in July 2006 at 14-30 (one kilometre south), and was perforated and fracture stimulated, yielding initial production rates of up to 1.1 MMcf/d of natural gas (183 BOE/d). Petro-Reef has a 54% interest in the well. Net production to Petro-Reef is 99 BOE/d. Completion tests will continue for 10 to 14 days.

In mid August, Petro-Reef plans to drill a well at 2-1 (1.4 kilometres northwest) as an offset test to the 5-31 oil and gas zone. A farmout agreement provides Petro-Reef with an 84% interest in the 2-1 well.

Petro-Reef has completed two other wells since June 14, 2006 at 16-30 and 1-31, resulting in two natural gas wells testing at a combined rate of 1.5 MMcf/d of natural gas (250 BOE/d). Petro-Reef has an interest of 34% in the 16-30 well and 54% in the 1-31 well. Net to Petro-Reef at an anticipated production rate of 900 Mcf/d is 61 BOE/d.

This was followed on September 14, 2006 with information on even more success.

Petro-Reef Resources Ltd. announces that it has encountered natural gas in three potential zones in the recently drilled well at 9-33, 1.7 kilometres northeast of its October 2005 natural gas discovery at 12-28 in Alexander, Alberta. The three potential zones include the producing zone at 12-28 plus two additional natural gas zones.

Weather permitting, the 9-33 will be production tested in the next two weeks to confirm the commercial potential of the three zones. The drilling rig has now been moved to 3-7 and is currently drilling. The 3-7 is exploratory and is being drilled on a new structure.

And on September 25, 2006 by:

Petro-Reef Resources Ltd. announces that it has encountered natural gas in two potential zones as well as crude oil in another potential zone in its recently drilled well at 3-7. The 3-7 well is located 4.8 kilometres northwest of Petro-Reef's October 2005 natural gas discovery in the well at 12-28 in the Alexander area of Alberta. The 3-7 was exploratory and was being drilled on a new structure.

Weather permitting, the well at 3-7 will be production tested in the next two to three weeks to confirm the commercial potential of the two natural gas zones. Petro-Reef expects to drill the oil zone at a later date. The drilling rig will be moved to 2-1 and is expected to begin drilling within three days. The 2-1 is a step-out well from producing wells at 6-1 and 5-31. The 2-1 well will help Petro-Reef determine the extent and boundaries of the producing formation.

And on October 20, 2006 by:

Petro-Reef Resources Ltd. announces that it has completed three successful production tests in the company's core area of Alexander, Alberta. The wells at 8-29, 9-33 and 3-7 were production tested based on extended wellhead deliverability natural gas rates and at existing pipeline operating pressures as follows:

| Well |        | Flow Rate   | Petro-Reef Interest | Petro-Reef Estimated Net Potential BOE/d |
|------|--------|-------------|---------------------|--|
| 8-29 |        | 827 Mcf/d   | 54.00%              | 74                                       |
| 9-33 | Zone A | 1,100 Mcf/d | 63.67%              | 117                                      |
|      | Zone B | 1,080 Mcf/d | 63.67%              | 115                                      |
| 3-7  | Zone A | 836 Mcf/d   | 54.00%              | 75                                       |
|      | Zone B | 3,930 Mcf/d | 54.00%              | 354                                      |

Petro-Reef expects to drill two more wells in the next two months at 9-33 and 3-7 to produce the additional gas zones that were tested but cannot be placed on stream due to potential problems with dual zone production. Additional oil zones that have also been identified are expected to be drilled at a later date.

The well at 2-1, which was announced on September 25, 2006, has finished drilling and production casing has been run. This well is a step-out well to the 5-31 and 6-1 producing oil discoveries. The well will be production tested for oil or natural gas in the next 30 days.

Two additional wells previously announced at 14-20 and 11-14 have not yet been drilled and are awaiting regulatory approval.

Petro-Reef's October 2005 natural gas discovery at 12-28 is still producing at 2,100 Mcf/d of natural gas. The well has reverted from an 84% interest to 34% after recovery of 400% of drilling and completion costs plus 200% of equipping and tie-in costs. Petro Reef's net production from the well is now 124 barrels of oil equivalent per day (BOE/d).

With Petro-Reef's existing production, the wells currently being tied-in, and the additional well tie-ins at 8-29, 9-33 and 3-7 the company expects net production to be at approximately 950 BOE/d by early December 2006. The company is on target to achieve its 2006 exit production target of between 1100 and 1550 BOE/d.

Petro-Reef provided an operations update in a December 19, 2006 news release.

Petro-Reef is pleased to report continued positive results from its field operations in Alexander. The well at 2-1 tested natural gas at an initial rate of 1.6 million cubic feet per day with approximately 10 barrels of oil per day. The 14-20 well has been drilled and production casing has been run. Testing will be done as soon as practical. The first twin well at 9-33 is drilling and Petro-Reef expects to run production casing before Christmas. Details will follow when available.

Subsequently Petro-Reef in 2007 drilled three additional successful wells with both natural gas and crude oil potential.

Success has created its own challenges. As each new high pressure natural gas well is added to the gathering pipeline system it becomes more difficult for the more distant, lower pressure wells continue producing at their current rates. As a result Petro-Reef is currently designing a major gas compressor facility to correct the problem and thereby significantly increase natural gas production. June is the target date for this project to become operational.



## **OUTLOOK**

Petro-Reef's current production is estimated to be approximately 700 BOE/d average March production. The Company expects to spend \$7.5 million to drill 16 wells (9.1 net) in 2007, all within the company's core operating area of Alexander/Qui Barre. Production has been up to 900 BOE/d but the average was reduced due to having to shut in producing wells while a twin well was being drilled.

## **FINANCING**

On July 19, 2005 Petro-Reef announced a private placement that was reported as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has agreed to issue by way of a private placement assistance of a finder. The Units are priced at \$0.45 and consist of one common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of Cdn \$0.70 per Common Share, if exercised within 18 months after the closing of this Offering. The Units will be issued pursuant to prospectus exemptions available under applicable securities legislation in Alberta and Ontario. Sinalta Investments Ltd. has undertaken to act as "finder" for which it will be paid a finders fee of \$100,000, and subject to the approval of the TSXV, the finder shall also be granted warrants to acquire up to 500,000 Common Shares of Petro-Reef at an exercise price of Cdn \$0.70 per Common Share, if exercised within 18 months after the closing of this Offering. The Company will use the proceeds for oil and gas development and exploration expenditures.

The financing is scheduled to close on or about July 28, 2005 or such other date as the finder and Petro-Reef may agree upon, and is conditional upon receiving regulatory approval, including approval of the TSX Venture Exchange and completion of definitive documentation.

On February 26, 2007 Petro-Reef Resources Ltd. announced that 3,499,987 out of a total 3,824,987 purchase warrants issued by the Corporation under financing that closed in August and September 2005 had been exercised. The warrants, which were exercisable at a price of \$0.70 per share, expired on February 20, 2007. As a result the Corporation has received aggregated proceeds of \$2,499,990.90.

On December 19, 2006 Petro-Reef announced another private placement as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. ("Primary") pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a "best efforts" basis, up to a maximum of 4,782,609 units ("Units") at a price of \$1.15 per Unit for an aggregate purchase price of \$5,500,000.35 (\$5,115,000.33 net of commissions). Primary will also receive an Over-Allotment Option to offer and sell an additional 478,261 Units for additional gross proceeds of up to \$550,000.15 (the "Over-Allotment Option"), which if exercised and fully sold, would give Petro-Reef gross proceeds of \$6,050,000.50 (\$5,626,500.47 net of commissions). Primary may exercise the Over-Allotment Option up to 2 business days prior to the Closing Date. The Closing Date is expected to be on or about January 19, 2007, or as otherwise agreed by Petro-Reef and Primary.

The Units are comprised of one common share of the Corporation ("Share") and one-half of one warrant ("Warrant"), each whole Warrant being exercisable to purchase one Share for a period of 18 months after the Closing Date at an exercise price of \$1.75 per Share, provided

that if the closing price of the Shares on the TSX Venture Exchange is equal to or greater than \$2.20 per Share for a period of 20 consecutive trading days any time after four months and one day after the Closing Date, the Corporation may accelerate the expiry date of the Warrants by giving notice to the holders thereof and in such case the Warrants will expire on the 30th day after the date on which such notice is given by the Corporation.

Petro-Reef has agreed to pay Primary a commission equal to 7% of the gross proceeds raised, and to issue broker warrants ("Broker Warrants") to it, entitling Primary to purchase up to that number of Units which is equal to 7% of the number of Units issued under the Offering, at an exercise price of \$1.15 per Unit at any time on or before the date which is 18 months after the Closing Date. These Units will be identical to those being offered under the private placement.

Assuming the exercise of all Warrants (including the Warrants comprising the Broker Warrants), Petro-Reef will realize additional gross proceeds of \$4,477,717.68 (\$4,925,489.54 if the Over-Allotment Option is fully exercised).

The Units will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Units will be used to fund the continued exploration and development of Petro-Reef's properties. Closing is subject to normal regulatory approvals. The Units will be subject to a four month hold period from the Closing Date.

The closing of this private placement was reported in a news release on January 26, 2007.

Petro-Reef Resources Ltd. has closed its previously announced private-placement financing, raising gross aggregate proceeds of \$6,050,000.50. The offering, announced on December 19, 2006, was fully subscribed. Petro-Reef plans to use the net proceeds of the offering to fund continued exploration and development of its core area in Alexander, Alberta.

The offering consisted of 5,260,870 units of the Corporation ("Units") at a price of \$1.15 per Unit. Each Unit consisted of one common share and one-half of the one common share purchase warrants of the Corporation. Each whole common share purchase warrant ("Warrant") is exercisable to acquire one common share of the Corporation at an exercise price of \$1.75 for a period ending on July 25, 2008. If the closing price of the common shares is higher than \$2.20 for a period of 20 consecutive days at any time after four months and one day after the closing date, the Corporation may accelerate the expiry date of the Warrants by giving notice to the holders. In such case, the Warrants would expire on the 30th day after the date on which notice is given.

Primary Capital Inc. served as the agent for the private-placement offering and received a 7% cash commission out of the gross proceeds and non-transferable broker warrants ("Broker Warrants") exercisable to acquire 368,260 units of the Corporation ("Broker Units") at a price of \$1.15 per Broker Unit until July 25, 2008. Each Broker Unit consists of one common share of the Corporation and one-half of one common share purchase warrant. Each whole common share purchase warrant exercisable to acquire one common share of the Corporation at a price of \$1.75 for a period ending on July 25, 2008.

After giving effect to this offering, Petro-Reef has 29,103,661 common shares issued and outstanding.



Subsequently on April 02, 2007 Petro-Reef announced a flow through share private placement as follows.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. ("Primary") pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a "best efforts" basis, up to a maximum of 1,500,000 common Shares ("Flow Through Shares") at a price of \$2.00 per share on a flow through basis for an aggregate purchase price of \$3,000,000 (\$2,805,000 net of commissions). The Closing Date is expected to be on or about April 13, 2007, or as otherwise agreed by Petro-Reef and Primary.

Petro-Reef has agreed to pay Primary a commission equal to 6.5% of the gross proceeds raised, and to issue broker warrants ("Broker Warrants") to it, entitling Primary to purchase up to that number of common shares of Petro-Reef which is equal to 6.5% of the number of Flow Through Shares issued under the Offering, at an exercise price of \$2.00 per share at any time on or before July 25, 2008. These shares will not carry flow through treatment.

The Flow Through Shares will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Flow Through Shares will be used to fund the continued exploration and development of Petro-Reef's properties. Closing is subject to normal regulatory approvals. The Flow Through Shares will be subject to a four month hold period from the Closing Date.

The financing closed as proposed on April 25, 2007.

On October 09, 2001 the Corporation entered into an operating line of credit with the National Bank of Canada with a credit facility in the form of a revolving operating demand loan with a limit of \$1 million dollars and a non-revolving acquisition demand loan with a maximum limit of one-half million dollars.

On December 30, 2003 the operating line of credit was increased to \$2 million dollars with the non-revolving demand loan for acquisitions and development remaining at one-half million dollars.

On July 24, 2006 the operating line of credit was increased to three million seven hundred and fifty thousand (\$3,750,000) dollars with the non-revolving demand loan for acquisitions and development increasing to \$1 million dollars.

The results of operations in 2004, 2005 and 2006 are set out in the following tables under three categories:

- 1) Land acquisitions
- 2) Petro-Reef operated wells
- 3) Wells where Petro-Reef is not the operator

Joint-venture partnerships are involved in both the operated and non-operated drilling and accounts for the varying interests held by Petro-Reef.

**LAND COSTS FOR THE ACQUISITION OF MINERAL LEASES  
(NET OF DISPOSITIONS, RENTALS OR SURFACE LEASES)**

| <u>YEAR</u>  | <u>PERIOD</u> | <u>GROSS<br/>ACRES</u> | <u>NET ACRES</u>    | <u>COST (NET)</u>       | <u>COMMENTS</u>            |
|--------------|---------------|------------------------|---------------------|-------------------------|----------------------------|
| 2004         | Q1            | 6                      | 3                   | \$ 480                  | Lease Service Only         |
|              | Q2            | -                      | -                   | \$ 466                  |                            |
|              | Q3            | 1,189                  | 404                 | \$16,140                |                            |
|              | Q4            | 1,829                  | 724                 | \$61,506                |                            |
| <b>TOTAL</b> |               | <b><u>3,024</u></b>    | <b><u>1,113</u></b> | <b><u>\$78,592</u></b>  | \$71 average per net acre  |
| 2005         | Q1            | 1,920                  | 653                 | \$103,316               | Lease Service Only         |
|              | Q2            | 480                    | 206                 | \$ 32,500               |                            |
|              | Q3            | 1,920                  | 960                 | \$ 51,837               |                            |
|              | Q4            | 968                    | 752                 | \$ 35,232               |                            |
| <b>TOTAL</b> |               | <b><u>5,288</u></b>    | <b><u>2,571</u></b> | <b><u>\$222,885</u></b> | \$87 average per net acre  |
| 2006         | Q1            | 824                    | 761                 | \$167,531               |                            |
|              | Q2            | 353                    | 42                  | \$ 27,885               |                            |
|              | Q3            | 253                    | 251                 | \$ 68,529               |                            |
|              | Q4            | 423                    | 340                 | \$ 99,797               |                            |
| <b>TOTAL</b> |               | <b><u>1,853</u></b>    | <b><u>1,394</u></b> | <b><u>\$363,743</u></b> | \$261 average per net acre |

Lease Service Only cost refers to third party land company expenses.

In 2006, 46% fewer net acres were acquired than in 2005, at an increased total cost of 63%.

The average cost per net acre increased significantly to \$261 in 2006 from \$87 in 2005.

**SELECTED FINANCIAL INFORMATION**

| <b>FINANCIAL (year-ended December 31)</b>                   | <b>2004</b> | <b>2005</b>  | <b>2006</b>  |
|---|-------------|--------------|--------------|
| Crude Oil and Natural Gas Revenue net of royalties and ARTC | \$2,162,656 | \$3,224,567  | \$5,749,891  |
| Cash Flow from Operations                                   | \$1,065,076 | \$2,007,713  | \$3,557,432  |
| Net (Loss) Earnings from Operations                         | (\$542,087) | \$248,714    | \$65,060     |
| Net (Loss) Earnings per Share, Basic and Diluted            | (\$0.03)    | \$0.01       | 0.00         |
| Capital Expenditures  | \$1,148,725 | \$2,374,843  | \$7,888,288  |
| Total Assets  | \$8,691,850 | \$10,462,289 | \$15,056,446 |
| Bank Balance (Loan)   | (\$700,000) | \$397,904    | (\$376,613)  |
| Shareholders' Equity  | \$4,021,269 | \$6,029,968  | \$7,919,194  |



The following table summarizes the results of the 12 most recently completed quarters.

| Summary of Quarterly Results For The Last Twelve Quarters |    |   |                        |   |
|---|----|---|------------------------|---|
|   |    | Oil & Gas Sales<br>Net of Royalties<br>And ARTC | Net Earnings<br>(Loss) | Basic and<br>Diluted<br>Earnings<br>Per Share |
| <b>2004</b>   |    |   | (Restated)             |   |
|   | Q1 | \$354,288                                       | (\$81,806)             | \$0.00  |
|   | Q2 | \$531,591                                       | (\$75,371)             | \$0.00  |
|   | Q3 | \$499,139                                       | \$34,086               | \$0.00  |
|   | Q4 | \$777,638                                       | (\$418,996)            | (\$0.03)                                      |
| <b>Total</b>  |    | <u>\$2,162,656</u>                              | <u>(\$542,087)</u>     |   |
| <b>2005</b>   |    |   |                        |   |
|   | Q1 | \$701,154                                       | (\$14,869)             | \$0.00  |
|   | Q2 | \$621,790                                       | (\$24,224)             | \$0.00  |
|   | Q3 | \$582,100                                       | (\$21,890)             | \$0.00  |
|   | Q4 | <u>\$1,319,523</u>                              | <u>\$309,697</u>       | <u>(\$0.01)</u>                               |
| <b>Total</b>  |    | <u>\$3,224,567</u>                              | <u>\$248,714</u>       |   |
| <b>2006</b>   |    |   |                        |   |
|   | Q1 | \$1,797,362                                     | \$75,453               | \$0.01  |
|   | Q2 | \$1,708,596                                     | \$2,619                | \$0.00  |
|   | Q3 | \$1,045,216                                     | (\$67,349)             | \$0.00  |
|   | Q4 | <u>\$1,198,717</u>                              | <u>\$54,337</u>        | <u>\$0.00</u>                                 |
| <b>Total</b>  |    | <u>\$5,749,891</u>                              | <u>\$65,060</u>        |   |

The following table summarizes the results of the 12 most recently completed quarters.

**PETRO-REEF RESOURCES LTD. OPERATED WELLS**

| <b>DRILLING, COMPLETION &amp; WORKOVERS</b> |                 |             |                   |
|---|-----------------|-------------|-------------------|
| <b>YEAR</b>                                 | <b>LOCATION</b> | <b>COST</b> | <b>PER % W.I.</b> |
| <b>2004</b>                                 |                 |             |                   |
| Q2  | 14-30-55-26W4   | \$147,450   | 24.00             |
|   | 05-31-55-26W4   | \$21,093    | 44.00             |
| Q3  | 14-30-55-26W4   | \$23,319    | 24.00             |
|   | 05-31-55-26W4   | \$17,741    | 44.00             |
|   | 09-30-56-24W4   | \$4,755     | 71.50             |
|   | 05-25-56-25W4   | \$192       | 39.00             |
| Q4  | 14-30-55-26W4   | \$1,757     | 24.00             |
|   | 05-31-55-26W4   | \$219       | 44.00             |
|   | 05-25-56-25W4   | \$18,612    | 39.00             |
| <b>2005</b>                                 |                 |             |                   |
| Q1  | 10-30-56-27W4   | \$17,284    | 35.13             |
|   | 13-29-55-26W4   | \$2,746     | 44.00             |
|   | 05-31-55-26W4   | \$1,641     | 44.00             |
|   | 06-15-56-27W4   | \$152       | 50.00             |
|   | 14-25-55-25W4   | \$13        | 15.96             |
|   | 16-26-55-25W4   | \$274       | 50.00             |
|   | 16-26-56-25W4   | \$332       | 25.88             |
|   | 04-19-56-24W4   | \$26,689    | 36.50             |
|   | 06-35-56-25W4   | \$639       | 61.28             |
|   | 07-32-56-25W4   | \$2,083     | 72.50             |
|   | 07-35-56-25W4   | \$440       | 62.27             |
|   | 05-25-56-25W4   | \$166       | 39.00             |
| Q2  | 10-30-56-27W4   | \$1,253     | 35.13             |
|   | 13-29-55-26W4   | \$193,660   | 44.00             |
|   | 14-30-55-26W4   | \$5,411     | 24.00             |
|   | 05-31-55-26W4   | \$31,294    | 44.00             |
|   | 14-25-55-25W4   | \$431       | 15.96             |
|   | 16-26-55-25W4   | \$329       | 50.00             |
|   | 05-36-55-25W4   | \$308       | 20.00             |
|   | 06-35-56-24W4   | \$3,333     | 61.28             |
|   | 07-32-56-25W4   | \$144       | 72.50             |
|   | 07-35-56-25W4   | \$63        | 62.27             |



| DRILLING, COMPLETION & WORKOVERS cont. |                |              |            |
|--|----------------|--------------|------------|
| YEAR                                   | LOCATION       | COST         | PER % W.I. |
| 2005                                   |                |              |            |
| Q3                                     | 12-28-55-26W4  | \$68,506     | 54.00      |
|  | 13-29-55-26W4  | \$34,348     | 44.00      |
|  | 05-31-55-26W4  | \$61,285     | 44.00      |
|  | 06-01-56-27W4  | \$7,297      | 44.00      |
|  | 06-15-56-27W4  | \$1,136      | 50.00      |
|  | 14-25-55-25W4  | \$59         | 15.96      |
|  | 16-26-55-25W4  | \$53         | 50.00      |
|  | 04-19-56-24W4  | \$383        | 36.50      |
|  | 05-36-55-25W4  | \$965        | 20.00      |
|  | 06-35-56-25W4  | \$2,183      | 62.27      |
|  | 07-32-56-25W4  | \$429        | 72.50      |
|  | 07-35-56-25W4  | \$501        | 62.27      |
| Q4                                     | 10-33-55-26W4  | \$13,025     | 54.00      |
|  | 11-27-55-26W4  | \$3,918      | 54.00      |
|  | 12-28-55-26W4  | \$488,346    | 54.00      |
|  | 12-33-55-26W4  | \$5,693      | 54.00      |
|  | 13-21-55-26W4  | \$4,271      | 54.00      |
|  | 13-29-55-26W4  | \$927        | 44.00      |
|  | 05-31-55-26W4  | \$6,362      | 44.00      |
|  | 06-01-56-27W4  | \$4,303      | 44.00      |
|  | 08-01-56-27W4  | \$128,790    | 44.00      |
|  | 05-36-55-25W4  | \$557        | 20.00      |
|  | 06-35-56-25W4  | \$1,105      | 61.28      |
|  | 07-35-56-25W4  | \$558        | 62.27      |
|  | 05-25-56-25W4  | \$25,852     | 39.00      |
| 2006                                   |                |              |            |
| Q1                                     | 10-33-55-26W4  | \$18,228.93  | 54.00      |
|  | 12-33-55-26W4  | \$129,352.11 | 44.00      |
|  | 13-21-055-26W4 | \$57,754.60  | 54.00      |
|  | 05-31-55-26W4  | \$13,943.26  | 64.00      |
|  | 06-01-56-27W4  | \$75,916.10  | 44.00      |
|  | 08-01-56-27W4  | \$51.11      | 59.00      |
|  | 11-27-55-26W4  | \$41,497.10  | 54.00      |
|  | 08-22-56-25W4  | \$688.05     | 31.2750257 |
|  | 05-25-56-25W4  | \$284.43     | 39.00      |
| Q2                                     | 01-31-55-26W4  | \$412,167.12 | 54.00      |
|  | 10-30-55-26W4  | \$527.64     | 35.13      |
|  | 10-33-55-26W4  | \$44,817.76  | 54.00      |
|  | 12-28-55-26W4  | \$25,976.73  | 34.00      |
|  | 12-33-55-26W4  | \$297,867.43 | 44.00      |
|  | 13-21-55-26W4  | \$212,982.06 | 54.00      |
|  | 13-29-55-26W4  | \$4.14       | 34.00      |

| DRILLING, COMPLETION & WORKOVERS cont. |                    |              |            |
|--|--------------------|--------------|------------|
| YEAR                                   | LOCATION           | COST         | PER % W.I. |
| 2006                                   |                    |              |            |
| Q2                                     | 14-30-55-26W4      | \$63.86      | 54.00      |
|  | 05-31-55-26W4      | \$340,717.11 | 64.00      |
|  | 06-01-56-27W4      | \$216,570.91 | 44.00      |
|  | 06-15-56-27W4      | \$1,327.99   | 50.00      |
|  | 08-01-56-27W4      | (\$41.82)    | 59.00      |
|  | 11-27-55-26W4      | \$403,279.33 | 54.00      |
|  | 05-36-55-25W4      | \$20.00      | 20.00      |
|  | 07-35-55-25W4      | \$9.95       | 19.9375    |
| Q3                                     | 01-31-55-26W4      | \$151,964.82 | 54.00      |
|  | 10-33-55-26W4      | \$1,200.47   | 54.00      |
|  | 11-14-55-26W4      | \$16,802.93  | 50.00      |
|  | 12-28-55-26W4      | \$1,717.00   | 34.00      |
|  | 12-33-55-26W4      | \$3,874.43   | 44.00      |
|  | 13-21-55-26W4      | \$3,736.83   | 54.00      |
|  | 13-29-55-26W4      | \$2,651.61   | 34.00      |
|  | 14-20-55-26W4      | \$23,460.82  | 64.00      |
|  | 14-30-55-26W4      | \$171,055.76 | 54.00      |
|  | 02-01-56-27W4      | \$36,553.06  | 84.00      |
|  | 03-07-56-26W4      | \$275,794.86 | 54.00      |
|  | 05-31-55-26W4      | \$174,189.08 | 64.00      |
|  | 06-01-56-27W4      | \$8,938.44   | 44.00      |
|  | 06-15-56-27W4      | \$166.90     | 50.00      |
|  | 08-01-56-27W4      | \$43,037.07  | 59.00      |
|  | 08-29-55-26W4      | \$65,111.86  | 54.00      |
|  | 100/09-33-055-26W4 | \$339,944.71 | 63.67      |
|  | 11-27-55-26W4      | \$50,309.04  | 54.00      |
|  | 05-36-55-25W4      | \$29.92      | 20.00      |
| Q4                                     | 01-31-55-26W4      | \$671.38     | 54.00      |
|  | 10-33-55-26W4      | \$2,041.70   | 54.00      |
|  | 11-14-56-27W4      | \$4,262.05   | 50.00      |
|  | 12-33-55-27W4      | \$2,498.08   | 44.00      |
|  | 13-21-55-26W4      | \$1,542.11   | 54.00      |
|  | 14-20-55-26W4      | \$372,319.38 | 64.00      |
|  | 14-30-55-26W4      | \$75.46      | 54.00      |
|  | 02-01-56-27W4      | \$559,690.34 | 84.00      |
|  | 03-07-56-26W4      | \$118,103.48 | 54.00      |
|  | 05-31-55-26W4      | (\$89.88)    | 64.00      |
|  | 06-01-56-27W4      | \$23,129.33  | 44.00      |
|  | 06-15-56-27W4      | \$1,108.97   | 50.00      |
|  | 08-01-56-27W4      | \$12,891.97  | 59.00      |
|  | 08-29-55-26W4      | \$265,803.50 | 54.00      |
|  | 100/09-33-55-26W4  | \$120,655.06 | 63.67      |
|  | 102/09-33-55-26W4  | \$201,223.23 | 44.00      |
|  | 11-27-55-26W4      | \$1,152.47   | 54.00      |
|  | 09-30-56-24W4      | \$63,305.18  | 71.50      |



**PETRO-REEF RESOURCES LTD. OPERATED WELLS**

| <b>EQUIPPING &amp; TIE-IN</b> |                    |             |                           |
|-------------------------------|--------------------|-------------|---------------------------|
| <b>YEAR</b>                   | <b>LOCATION</b>    | <b>COST</b> | <b>PER<br/>%<br/>W.I.</b> |
| <b>2004</b>                   |                    |             |                           |
| Q1                            | 10-30-56-27W4      | \$22,260    | 35.13                     |
|                               | 05-31-55-26W4      | \$93,669    | 44.00                     |
|                               | 09-30-56-24W4      | \$39,216    | 71.50                     |
| Q2                            | 05-31-55-26W4      | \$34,438    | 44.00                     |
|                               | 09-30-56-24W4      | \$35,710    | 71.50                     |
| Q3                            | 14-30-55-26W4      | \$57,570    | 34.00                     |
|                               | 05-31-55-26W4      | \$4,444     | 44.00                     |
|                               | 09-30-56-24W4      | \$231       | 71.50                     |
| Q4                            | 14-30-55-26W4      | \$278       | 34.00                     |
|                               | 05-31-55-26W4      | (\$61)      | 44.00                     |
| <b>2005</b>                   |                    |             |                           |
| Q1                            | 14-30-55-26W4      | \$3,333     | 24.00                     |
|                               | 05-31-55-26W4      | \$35,216    | 44.00                     |
|                               | 04-19-56-24W4      | \$68,343    | 36.50                     |
|                               | 05-25-56-25W4      | \$63,341    | 39.00                     |
|                               | 09-30-56-24W4      | \$7,299     | 71.50                     |
| Q2                            | 10-30-56-27W4      | \$5,109     | 35.13                     |
|                               | 13-29-55-26W4      | \$3,105     | 34.00                     |
|                               | 14-30-55-26W4      | \$278       | 24.00                     |
|                               | 04-19-56-24W4      | \$221       | 36.50                     |
|                               | 09-30-56-24W4      | \$11,895    | 71.50                     |
| Q3                            | 13-29-55-26W4      | \$2,112     | 44.00                     |
|                               | 14-30-55-26W4      | \$88        | 44.00                     |
| Q4                            | 12-28-55-26W4      | \$345,486   | 54.00                     |
|                               | 14-30-55-26W4      | \$22,355    | 24.00                     |
|                               | 05-31-55-26W4      | \$5,333     | 64.00                     |
|                               | 06-01-56-27W4      | \$134       | 44.00                     |
|                               | 08-01-56-27W4      | \$97,678    | 44.00                     |
|                               | 05-25-56-25W4      | (\$11,032)  | 39.00                     |
|                               | 09-30-56-24W4      | \$18,389    | 71.50                     |
| <b>2006</b>                   |                    |             |                           |
| Q1                            | 12-28-55-26W4      | \$2,378.22  | 34.00                     |
|                               | 05-31-55-26W4Plant | \$29,033.20 | 49.00                     |
|                               | 06-01-56-27W4      | \$12,194.95 | 44.00                     |
|                               | 08-01-56-27W4      | \$8,581.26  | 59.00                     |
|                               | 05-25-56-25W4      | \$1,040.54  | 39.00                     |

**PETRO-REEF RESOURCES LTD. OPERATED WELLS**

| <b>YEAR</b> | <b>LOCATION</b>    | <b>COST</b>   | <b>PER<br/>%<br/>W.I.</b> |
|-------------|--------------------|---------------|---------------------------|
| <b>2006</b> |                    |               |                           |
| <b>Q2</b>   | 01-31-55-26W4      | \$6,706.89    | 54.00                     |
|             | 10-33-55-26W4      | \$10,624.70   | 54.00                     |
|             | 12-28-55-26W4      | \$1,960.55    | 34.00                     |
|             | 12-33-55-26W4      | \$15,028.22   | 44.00                     |
|             | 16-30-55-26W4      | \$544.60      | 34.00                     |
|             | 06-01-56-27W4      | \$82,848.33   | 44.00                     |
|             | 08-01-56-27W4      | (\$49,195.00) | 59.00                     |
|             | 11-27-55-26W4      | \$24,083.23   | 54.00                     |
| <b>Q3</b>   | 12-28-55-26W4      | \$65,115.48   | 34.00                     |
|             | 12-33-55-26W4      | \$132,477.46  | 44.00                     |
|             | 14-30-55-26W4      | \$74,988.24   | 54.00                     |
|             | 16-30-55-26W4      | \$65,629.04   | 34.00                     |
|             | 05-31-55-26W4      | \$115,650.92  | 64.00                     |
|             | 05-31-55-26W4Plant | \$10,673.97   | 49.00                     |
|             | 06-01-56-27W4      | \$4,209.47    | 44.00                     |
|             | 100/09-33055-26W4  | \$26,575.34   | 63.67                     |
| <b>Q4</b>   | 11-27-55-26W4      | \$275,451.10  | 54.00                     |
|             | 12-28-55-26W4      | \$13,591.77   | 34.00                     |
|             | 12-33-55-26W4      | \$233,729.05  | 44.00                     |
|             | 14-20-55-26W4      | \$17,758.49   | 64.00                     |
|             | 14-30-55-26W4      | \$1,997.24    | 54.00                     |
|             | 16-30-55-26W4      | \$2,540.93    | 34.00                     |
|             | 02-01-56-27W4      | \$32,726.51   | 84.00                     |
|             | 03-07-56-26W4      | \$142,661.06  | 54.00                     |
|             | 05-31-55-26W4      | \$32,221.22   | 64.00                     |
|             | 06-01-56-27W4      | \$353.77      | 44.00                     |
|             | 08-01-56-27W4      | (\$15,165.15) | 59.00                     |
|             | 08-29-55-26W4      | \$145,069.75  | 54.00                     |
|             | 100/09-33-55-26W4  | \$152,291.09  | 63.67                     |
|             | 11-27-55-26W4      | \$806.29      | 54.00                     |
|             | 05-25-56-25W4      | (\$29,143.69) | 39.00                     |
|             | 09-30-56-24W4      | \$76,066.95   | 71.50                     |



**PETRO-REEF RESOURCES LTD. NON-OPERATED WELLS**

| <b>DRILLING, COMPLETION &amp; WORKOVERS</b> |                 |             |                       |                           |
|---|-----------------|-------------|-----------------------|---------------------------|
| <b>Year</b>                                 | <b>Location</b> | <b>Cost</b> | <b>Status</b>         | <b>PER<br/>%<br/>W.I.</b> |
| <b>2004</b>                                 |                 |             |                       |                           |
| Q4  | 06-07-56-25W4   | \$7,581     | Producing<br>Gas Well | 12.50                     |
| Q4  | 01-20-56-27W4   | \$3,895     | Producing<br>Gas Well | 1.04                      |
| <b>2005</b>                                 |                 |             |                       |                           |
| Q1  | 15-36-55-27W4   | \$2,056.67  | Producing<br>Gas Well | 2.09375                   |
| Q2  | 06-07-55-25W4   | \$23,092.89 | Producing<br>Gas Well | 12.50                     |
| <b>2006</b>                                 |                 |             |                       |                           |
| Q1  | 07-21-56-27W4   | \$713.82    | Producing<br>Gas Well | 50.00                     |
| Q1  | 14-25-55-25W4   | \$13.97     | Producing<br>Gas Well | 28.0125                   |
| Q1  | 06-35-56-25W4   | \$31.84     | Producing<br>Gas Well | 61.2750257                |
| Q1  | 06-07-56-25W4   | (\$382.50)  | Producing<br>Gas Well | 60.9375                   |
| Q2  | 06-35-56-25W4   | \$30.56     | Producing<br>Gas Well | 61.2750257                |
| Q3  | 06-35-56-25W4   | \$481.53    | Producing<br>Gas Well | 61.2750257                |
| Q4  | 14-29-56-25W4   | \$93.19     | Producing<br>Gas Well | 100.00                    |
| Q4  | 03-05-56-25W4   | \$169.93    | Producing<br>Gas Well | 100.00                    |

**PETRO-REEF RESOURCES LTD. NON-OPERATED WELLS**

| <b>Year</b>   | <b>Location</b> | <b>Cost</b> | <b>Status</b>         | <b>PER<br/>%<br/>W.I.</b> |
|---|-----------------|-------------|-----------------------|---------------------------|
| <b>2004</b>   |                 |             |                       |                           |
| Q4  | 06-07-56-25W4   | \$9,397     | Producing<br>Gas Well | 60.9375                   |
| Q4  | 01-20-56-27W4   | \$4,236     | Producing<br>Gas Well | 1.04                      |
| Q4  | 15-25-56-25W4   | \$2,756     | Producing<br>Gas Well | 1.2750257                 |
| <b>2005 Note: There were no wells equipped or tied-in where<br/>Petro-Reef was not the operator</b> |                 |             |                       |                           |
| <b>2006</b>   |                 |             |                       |                           |
| Q1  | 06-07-56-25W4   | \$1,575.40  | Producing<br>Gas Well | 60.9375                   |
| Q1  | 15-22-58-25W4   | \$243.49    | Producing<br>Gas Well | 100.00                    |
| Q2  | 01-20-56-27W4   | \$80.01     | Producing<br>Gas Well | 1.04                      |
| Q2  | 15-36-55-26W4   | \$70,107.91 | Producing<br>Gas Well | 21.094                    |
| Q3  | 15-36-55-26W4   | \$10,413.92 | Producing<br>Gas Well | 21.094                    |
| Q4  | 15-36-55-26W4   | \$4,279.28  | Producing<br>Gas Well | 21.094                    |



The following table represents the pro-forma budget and cash flow for 2007 as prepared by management in respect of revenues expected, less expenses (royalties, operating, interest, general and administrative and professional fees), cash flow, capital expenditures, and net cash flow for the periods indicated.

**PETRO-REEF CASH FLOW AND PRO-FORMA BUDGET FOR 2007**  
**QUARTER ENDED**

|  | (\$000's)       |                |                 |                |              |
|--|-----------------|----------------|-----------------|----------------|--------------|
|  | <u>March 31</u> | <u>June 30</u> | <u>Sept. 30</u> | <u>Dec. 31</u> | <u>Total</u> |
| <b>Gross Crude Oil &amp; Natural Revenue</b> |                 |                |                 |                |              |
| Net of Royalties, ARTC and Operating         | 1,425           | 1,500          | 1,782           | 1,923          | 6,630        |
| <b>Expenses</b>                              |                 |                |                 |                |              |
| General and Administrative                   | 318             | 318            | 318             | 318            | 1,272        |
| <b>Cash Flow (Before Capital)</b>            | 1,107           | 1,182          | 1,464           | 1,605          | 5,358        |
| <b>Capital Cost</b>                          |                 |                |                 |                |              |
| --Drilling, Completion & Tie-In              | 1,499           | 1,333          | 2,765           | 1,865          | 7,462        |
| -Seismic & Land                              | 386             | 408            | 568             | -              | 1,362        |
| <b>Net Cash Flow (After Capital)</b>         | (778)           | (559)          | (1,869)         | (260)          | (3,466)      |
| <b>Bank Loan repaid (\$000's)</b>            | (375)           |                |                 |                | (375)        |
| <b>Other</b>                                 |                 |                |                 |                |              |
| - Alberta Royalty Tax Credit                 | 152             |                |                 |                | 152          |
| - Warrants Exercised                         | 2,001           |                |                 |                | 2,001        |
| - Private Placements                         | 5,601           | 2,800          |                 |                | 8,401        |
| <b>Cash on Hand</b>                          | 6,601           | 8,842          | 6,973           | 6,713          | 6,713        |

Note (1) Due to plant shut down from May 1-13, 2007 for maintenance, revenue will be reduced

Note (2) Royalties and operating expenses are estimated at 40% of gross revenue

Note (3) Management has determined that the Cash Flow estimates can be attained through a combination of cash on hand, cash flow, private placements and necessary bank financing

Note (4) Revenue from wells drilled during the year is not included. The gross of \$6,630,000 is extracted from the independent engineering report as an estimate and not revenues from existing production

Petro-Reef's short-term requirements for cash are met by cash on hand, current cash flow from operations and bank financing. Management has determined that Petro-Reef's cash flow estimates can be attained through a combination of these sources. Long-term cash requirements will depend on the success of the drilling program. Currently, long-term financing is done with bank financing and current cash flow from operations. Consideration for future financing will include increase in bank financing, and issuance of shares from treasury. The company is not nor does it expect to be in default of any of its obligations.

Petro-Reef has no off-balance sheet arrangements.

As the time of writing this report Petro-Reef is not considering any proposed acquisitions or dispositions outside the normal course of business. If, as and when the transaction is proposed, and finalized it shall be reported as required.

The present office lease agreement expires on September 30, 2011. Future lease payments, excluding operating costs, to the end of the lease term are as follows:

|      |          |
|------|----------|
| 2007 | \$77,577 |
| 2008 | \$80,922 |
| 2009 | \$84,258 |
| 2010 | \$86,762 |
| 2011 | \$65,070 |

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$391,648 (2005 – \$217,915) as at December 31, 2006 based on a total future liability of \$711,198 (2005 – 389,677), which will be incurred between 2006 and 2025. A credit adjusted risk free rate of 5.36% (2005 – 6.08%) and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

|                              | 2006             | 2005             |
|------------------------------|------------------|------------------|
| Balance, beginning of year   | \$217,915        | \$155,456        |
| Liabilities incurred in year | 142,379          | 64,423           |
| Liabilities settled in year  | (432)            | (15,229)         |
| Accretion expense            | 31,786           | 13,265           |
|                              |                  |                  |
| Balance, end of year         | <u>\$391,648</u> | <u>\$217,915</u> |

The authorized share capital of the company is comprised of an unlimited number of common shares. Details of the changes in the company's issued share capital during 2006 and 2005 are as follows:

|  | 2006                |                  | 2005                |                  |
|--|---------------------|------------------|---------------------|------------------|
| Common Shares                              | Number of<br>shares | Amount<br>\$     | Number of<br>shares | Amount<br>\$     |
| Balance – Beginning of year                | 21,438,924          | 5,558,614        | 17,738,937          | 4,772,876        |
| Issued for the exercise of:                | 1,180,000           | 1,042,909        |                     |                  |
| Stock options                              | 1,066,367           | 959,737          | 200,000             | 101,060          |
| Unit private placement                     | -                   | -                | 3,499,987           | 874,995          |
| Share issue costs (net of \$96,500 of tax) | -                   | (1,500)          | --                  | 190,317          |
|  |                     |                  |                     |                  |
| <b>Balance – End of year</b>               | <b>23,685,291</b>   | <b>7,559,760</b> | <b>21,438,924</b>   | <b>5,558,614</b> |

Basic and diluted earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the year of 25,413,664 (2005 – 21,747,157).



The company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the company's stock on the date of grant. Options are vested over three years and expire after a maximum exercise period of five years from the date of issuance. A summary of the status of the company's stock option plan as of December 31, 2006 and 2005 and changes during the year is presented below:

|                           | 2006                 |                                       | 2005                 |                                       |
|---------------------------|----------------------|---------------------------------------|----------------------|---------------------------------------|
|                           | Number of<br>Options | Weighted<br>Average<br>Exercise Price | Number of<br>Options | Weighted<br>Average<br>Exercise Price |
| Balance beginning of year | 2,120,000            | \$0.50                                | 1,510,000            | \$0.49                                |
| Granted                   | 1,040,000            | 1.24                                  | 810,000              | 0.50                                  |
| Exercised                 | (1,180,000)          | (0.50)                                | (200,000)            | (0.40)                                |
| Expired                   | -                    | -                                     | -                    | -                                     |
| Balance end of year       | <u>1,980,000</u>     | <u>0.89</u>                           | <u>2,120,000</u>     | <u>\$ 0.50</u>                        |
| Exercisable end of year   | <u>940,000</u>       | <u>0.50</u>                           | <u>1,310,000</u>     | <u>\$ 0.50</u>                        |

The following table summarizes information about stock options outstanding at December 31, 2006:

| Exercise Price | Options outstanding   |   | Options exercisable   |   |
|----------------|-----------------------|---|-----------------------|---|
|                | Number<br>Outstanding | Weighted Average<br>Remaining<br>Contractual Life | Number<br>Exercisable | Weighted Average<br>Remaining<br>Contractual Life |
| \$0.42         | 350,000               | 1.52  | 350,000               | 1.52  |
| 0.50           | 430,000               | 3.54  | 430,000               | 3.54  |
| 0.52           | 10,000                | 3.65  | 10,000                | 3.65  |
| 0.70           | 100,000               | 2.46  | 100,000               | 2.46  |
| 0.71           | 50,000                | 2.21  | 50,000                | 2.21  |
| 0.90           | 40,000                | 4.87  | -                     | -   |
| 1.05           | 50,000                | 4.73  | -                     | -   |
| 1.20           | 390,000               | 4.82  | -                     | -   |
| 1.30           | <u>560,000</u>        | <u>4.47</u>                                       | -                     | -   |
|                | <u>1,980,000</u>      | <u>3.70</u>                                       | <u>940,000</u>        | <u>2.68</u>                                       |

Compensation cost of \$481,709 (2005 - \$176,308) has been recognized for stock options granted during the year.

The weighted average fair value of each option granted during the year ended December 31, 2006 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

|  | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|
| Fair value of options granted (\$/share) | \$ 0.78     | \$0.33      |
| Risk-free interest rate (%)              | 4.02        | 3.40        |
| Expected life (years)                    | 3           | 3           |
| Expected volatility (%)                  | 1.30        | 102         |
| Expected dividend yield (%)              | -           | -           |

#### CONTRIBUTED SURPLUS

|  | <u>2006</u>      | <u>2005</u>      |
|--|------------------|------------------|
| Balance – Beginning of year                  | <u>\$534,308</u> | <u>\$380,060</u> |
| Stock based compensation expense             | \$481,709        | \$176,308        |
| Adjustment for options exercised in the year | (\$445,408)      | (\$22,060)       |
| Balance – End of year                        | <u>\$570,609</u> | <u>\$534,308</u> |

**PETRO-REEF RESOURCES LTD.  
CORPORATE INFORMATION**

**DIRECTORS AND OFFICERS**

**Joseph Werner<sup>(4)</sup>**

Chief Executive Officer  
President & Director  
Calgary, Alberta

**Theodore M. Donhuysen<sup>(4)(5)</sup>**

Vice-President Exploration & Production  
Chief Operating Officer & Director  
Calgary, Alberta

**Alan P. Hallman<sup>(2)</sup>**

Director  
Calgary, Alberta

**Dennis K. Ulrich<sup>(3)</sup>**

Director  
Medicine Hat, Alberta

**Jack P. Donhuysen<sup>(2)(5)</sup>**

Director  
Calgary, Alberta

**Huba A. Sebo<sup>(1)(5)</sup>**

Director  
Calgary, Alberta

**Richard W. DeVries<sup>(1)(2)</sup>**

Director  
Freeport, The Bahamas

**Robert N. Maertens-Poole<sup>(4)</sup>**

Director  
Chief Financial Officer  
Calgary, Alberta

**Gary W. Coleman<sup>(3)</sup>**

Director, Assistant Secretary  
Calgary, Alberta

**R. Greg Powers<sup>(3)(6)</sup>**

Director  
Corporate Secretary  
Legal Counsel  
Calgary, Alberta

**Head Office**

970 – 10655 Southport Road S.W.  
Calgary, Alberta T2W 4Y1  
Telephone: +1 (403) 265-6444  
Facsimile: +1 (403) 264-1348  
E-mail: [info@petro-reef.ca](mailto:info@petro-reef.ca)  
Website: [www.petro-reef.ca](http://www.petro-reef.ca)

**Stock Listing**

TSX Venture Exchange  
Trading Symbol: **PER**

**Auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants  
3100, 111 - 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 5L3

**Bank**

National Bank of Canada  
301 – 6<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 4M9

**Registrar and Transfer Agent**

CIBC Mellon Trust Company  
600, 333 - 7<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 2Z1

**Investor Relations**

Bryan Mills Iradesso  
400, 805 – 10<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2R 0B4

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee
- (3) Member of the Corporate Governance Committee
- (4) Member of the Management Committee
- (5) Member of the Reserves Committee
- (6) Fasken Martineau DuMoulin LLP  
3400 First Canadian Centre  
350 – 7<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 3N9



## **RESERVES REPORT**

### **Form 51-101F1**

Petro-Reef's proved plus probable reserves, based on an independent engineering year-end evaluation, indicated an increase of 167.2 percent to 1345.5 MBOE from 503.5 MBOE in the previous year, after extensions, technical revisions, and net production of 118 MBOE.

Reserves were 92.98% natural gas and 7.02% crude oil and natural gas liquids. Reserve replacement ratio was 7.14 to 1.

Of the total net reserves reported (using forecast prices) Petro-Reef's reserves are 88.3% proved and 11.7% probable.

Reserves are classified according to the degree of certainty associated with the estimates.

#### **1) Proved Reserves**

Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.

#### **2) Probable Reserves**

Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

#### **3) Possible Reserves**

Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated proved plus probable plus possible reserves. Possible reserves have not been considered in this report.

## **RESERVES RECONCILIATION**

The December 31, 2006 evaluation was prepared using definitions in accordance with National Instrument 51-101. Estimates are prepared such that there is a 90% probability that at least the estimated proved reserves will be recovered and a 50% probability that at least the sum of the estimated proved reserves plus probable reserves will be recovered. The reserves reconciliation reflects current proved plus probable reserves. Both the December 31, 2005 and the December 31, 2006 reports were prepared by Sproule Associates Limited.

**1) Reserves Value**

Using a ten percent (10%) NPV, the value of proved plus probable reserves at constant prices and Costs (before Income Taxes) increased by Twenty Eight percent (28%) compared with last year's established reserves.

**2) Reserve Life Index (as at December 31, 2006).**

Based on established reserves and production volumes, Petro-Reef's reserve life index was 33.9 years at the end of 2006 compared with 23 years at the end of 2005. Petro-Reef's reserve life index (RLI) is an indication of the number of years it would take to deplete the Company's reserves. The RLI is obtained by dividing the year end reserves by the average daily production of oil, natural gas and natural gas liquids for a calendar year as estimated and determined by the independent reserves evaluator.

**3) Evaluation Standards**

This report has been prepared by Sproule Associates Limited using state-of-the-art geological and engineering knowledge and techniques. It has been prepared with the Code of Ethics of the Association of Professional Engineers, Geologists and Geophysicists of Alberta ("APEGGA"). Finally, this report adheres in all material aspects to the "best practices" recommended in the COGE Handbook which are in accordance with principals and definitions established by the Calgary Chapter of the Society of Petroleum Evaluation Engineers. The COGE Handbook is incorporated by reference in National Instrument 51-101.

**4) The Evaluation of the petroleum and natural gas**

The Evaluation of the petroleum and natural gas reserves of Petro-Reef Resources Ltd. has been approved by the company's reserve committee and the board of directors.

**5) Statement of Reserves Data**

Following is a detailed report on the reserves and future net revenue in six parts:

|        |  |
|--------|--|
| Part 1 | Date of Statement  |
| Part 2 | Disclosure of Reserves Data                                    |
| Part 3 | Pricing Assumptions  |
| Part 4 | Reconciliation's of changes in Reserves and Future Net Revenue |
| Part 5 | Additional Data Relating to Reserves Data                      |
| Part 6 | Other Oil and Gas Information                                  |

**FORM 51-101F1**  
**STATEMENT OF RESERVES DATA**  
**AND OTHER OIL AND GAS INFORMATION**

**TABLE OF CONTENTS**

|          |   |
|----------|---|
| PART 1   | DATE OF STATEMENT   |
| Item 1.1 | Relevant Dates  |
| PART 2   | DISCLOSURE OF RESERVES DATA   |
| Item 2.1 | Reserves Data (Forecast Prices and Costs)                           |
| Item 2.2 | Reserves Data (Constant Prices and Costs)                           |
| PART 3   | PRICING ASSUMPTIONS   |
| Item 3.1 | Forecast Prices Used in Estimates                                   |
| Item 3.2 | Constant Prices Used in Estimates                                   |
| PART 4   | RECONCILIATIONS OF CHANGES IN RESERVES AND FUTURE NET REVENUE       |
| Item 4.1 | Reserves Reconciliation   |
| Item 4.2 | Future Net Revenue Reconciliation (Constant Prices and Costs)       |
| PART 5   | ADDITIONAL INFORMATION RELATING TO RESERVES DATA                    |
| Item 5.1 | Undeveloped Reserves  |
| Item 5.2 | Significant Factors or Uncertainties                                |
| Item 5.3 | Future Development Costs  |
| PART 6   | OTHER OIL AND GAS INFORMATION                                       |
| Item 6.1 | Oil and Gas Properties and Wells                                    |
| Item 6.2 | Properties With No Attributed Reserves                              |
| Item 6.3 | Forward Contracts   |
| Item 6.4 | Additional Information Concerning Abandonment and Reclamation Costs |
| Item 6.5 | Tax Horizon   |
| Item 6.6 | Costs Incurred  |
| Item 6.7 | Exploration and Development Activities                              |
| Item 6.8 | Production Estimates  |
| Item 6.9 | Production History  |



## PART 1 DATE OF STATEMENT

### 1.1 Relevant Dates

1. Date the statement: April 05, 2007
2. Effective date: December 31, 2006
3. Preparation date: Between February 1 and April 2, 2007

## PART 2 DISCLOSURE OF RESERVES DATA

### 2.1 Reserves Data (Forecast Prices and Costs)

#### 2.1.1 Reserves Gross and Net (Forecast Prices and Costs)

| <b>N1 51-101</b><br><b>Summary of Oil and Gas Reserves</b><br><b>as of December 31, 2006</b><br><b>Forecast Prices and Costs</b> |                      |            |              |            |   |              |                 |            |                     |            |
|--|----------------------|------------|--------------|------------|---|--------------|-----------------|------------|---------------------|------------|
| Reserves   |                      |            |              |            |   |              |                 |            |                     |            |
|  | Light and Medium Oil |            | Heavy Oil    |            | Natural Gas Liquids (non-associated & associated) |              | Coalbed Methane |            | Natural Gas Liquids |            |
| Reserves Category  | Gross (Mbbl)         | Net (Mbbl) | Gross (Mbbl) | Net (MMcf) | Gross (MMcf)                                      | Net (MMcf)   | Gross (MMcf)    | Net (MMcf) | Gross (Mbbl)        | Net (Mbbl) |
| <b>Proved</b>  |                      |            |              |            |   |              |                 |            |                     |            |
| Developed Producing  | 42                   | 37         | 0            | 0          | 5,789   | 4,786        | 0               | 0          | 9                   | 8          |
| Developed Non-Producing  | 0                    | 0          | 0            | 0          | 9   | 8            | 0               | 0          | 0                   | 0          |
| Undeveloped  | 32                   | 28         | 0            | 0          | 2,360   | 1,894        | 0               | 0          | 0                   | 0          |
| <b>Total Proved</b>  | <b>74</b>            | <b>66</b>  | <b>0</b>     | <b>0</b>   | <b>8,159</b>                                      | <b>6,688</b> | <b>0</b>        | <b>0</b>   | <b>9</b>            | <b>8</b>   |
| Probable   | 22                   | 20         | 0            | 0          | 992   | 817          | 0               | 0          | 2                   | 1          |
| <b>Total Proved Plus Probable</b>  | <b>96</b>            | <b>86</b>  | <b>0</b>     | <b>0</b>   | <b>9,151</b>                                      | <b>7,505</b> | <b>0</b>        | <b>0</b>   | <b>11</b>           | <b>9</b>   |

## 2.1.2 Net Present Value of Future Net Revenue (Forecast Prices and Costs)

| <b>N1 51-101</b><br><b>Summary of Net Present Values of</b><br><b>Future Net Revenue</b><br><b>as of December 31, 2006</b><br><b>Forecast Prices and Costs</b> |   |               |               |               |               |  |               |               |               |               |
|--|---|---------------|---------------|---------------|---------------|--|---------------|---------------|---------------|---------------|
|  | Net Present Values of Future Net Revenue        |               |               |               |               |  |               |               |               |               |
|  | Before Income Taxes<br>Discounted at (% / Year) |               |               |               |               | After Income Taxes<br>Discounted at (% / Year) |               |               |               |               |
| Asset Category   | 0<br>(M\$)                                      | 5<br>(M\$)    | 10<br>(M\$)   | 15<br>(M\$)   | 20<br>(M\$)   | 0<br>(M\$)                                     | 5<br>(M\$)    | 10<br>(M\$)   | 15<br>(M\$)   | 20<br>(M\$)   |
| <b>Proved</b>  |   |               |               |               |               |  |               |               |               |               |
| Developed Producing  | 31,812  | 24,942        | 20,790        | 18,017        | 16,026        | 25,676   | 20,385        | 17,168        | 15,005        | 13,443        |
| Developed<br>Non-Producing   | 48  | 26            | 15            | 9             | 5             | 34   | 19            | 10            | 6             | 4             |
| Undeveloped  | 11,331  | 8,916         | 7,250         | 6,045         | 5,141         | 7,980  | 6,185         | 4,947         | 4,053         | 3,384         |
| <b>Total Proved</b>  | <b>43,190</b>                                   | <b>33,885</b> | <b>28,054</b> | <b>24,070</b> | <b>21,173</b> | <b>33,689</b>                                  | <b>26,588</b> | <b>22,125</b> | <b>19,064</b> | <b>16,831</b> |
| Probable   | 6,130   | 4,823         | 3,971         | 3,378         | 2,945         | 4,323  | 3,393         | 2,787         | 2,367         | 2,059         |
| <b>Total Proved Plus<br/>Probable</b>  | <b>49,320</b>                                   | <b>38,707</b> | <b>32,025</b> | <b>27,449</b> | <b>24,118</b> | <b>38,013</b>                                  | <b>29,981</b> | <b>24,912</b> | <b>21,431</b> | <b>18,890</b> |

### Notes:

- 1) NPV of FNR include all resource income:
  - Sale of oil, gas, by-product reserves
  - Processing third party reserves
  - Other income
- 2) Income Taxes
  - Includes all resource income
  - Apply appropriate income tax calculations
  - Include prior tax pools

### 2.1.3 Future Net Revenue Undiscounted (Forecast Prices and Costs)

| <b>N1 51-101</b><br><b>Total Future Net Revenue</b><br><b>Undiscounted</b><br><b>as of December 31, 2006</b><br><b>Forecast Prices and Costs</b> |                      |                        |                              |                                |  |   |                           |  |
|--|----------------------|------------------------|------------------------------|--------------------------------|--|---|---------------------------|--|
| <b>Reserves Category</b>   | <b>Revenue (M\$)</b> | <b>Royalties (M\$)</b> | <b>Operating Costs (M\$)</b> | <b>Development Costs (M\$)</b> | <b>Well Abandonment/ Other Costs (M\$)</b> | <b>Future Net Revenue Before Income Taxes (M\$)</b> | <b>Income Taxes (M\$)</b> | <b>Future Net Revenue After Income Taxes (M\$)</b> |
| Proved   | 77,465               | 15,574                 | 15,620                       | 2,708                          | 374  | 43,190  | 9,500                     | 33,689   |
| Proved Plus Probable   | 87,534               | 17,581                 | 17,529                       | 2,708                          | 396  | 49,320  | 11,307                    | 38,013   |

### 2.1.4 By Production Group-Future Net Revenue before Income Tax (Using Forecast Prices and Costs – Using a discount rate of 10%)

| <b>N1 51-101</b><br><b>Net Present Value of Future Net Revenue</b><br><b>By Production Group</b><br><b>as of December 31, 2006</b><br><b>Forecast Prices and Costs</b> |  |  |
|--|--|--|
| <b>Reserves Category</b>   | <b>Production Group</b>  | <b>Future Net Revenue Before Income Taxes (Discounted at 10% Year) (M\$)</b> |
| Proved   | Light and Medium Crude Oil (including solution gas and associated by-products) | 1,386  |
|  | Heavy Oil (including solution gas and associated by-products)                  | 0  |
|  | Natural Gas (including associated by-products)                                 | 26,331   |
|  | Coalbed Methane (including associated by-products)                             | 0  |
| Proved Plus Probable Reserves  | Light and Medium Crude Oil (including solution gas and associated by-products) | 1,691  |
|  | Heavy Oil (including solution gas and associated by-products)                  | 0  |
|  | Natural Gas (including associated by-products)                                 | 29,997   |
|  | Coalbed Methane (including associated by-products)                             | 0  |



## 2.2 Reserves Data (Constant Prices and Costs)

### 2.2.1 Reserves Gross and Net (Constant Prices and Costs)

| <b>N1 51-101</b><br><b>Summary of Oil and Gas Reserves</b><br><b>as of December 31, 2006</b><br><b>Constant Prices and Costs</b> |                      |            |              |              |  |              |                 |            |                     |            |
|--|----------------------|------------|--------------|--------------|--|--------------|-----------------|------------|---------------------|------------|
| Reserves   |                      |            |              |              |  |              |                 |            |                     |            |
|  | Light and Medium Oil |            | Heavy Oil    |              | Natural Gas Liquids<br>(non-associated & associated) |              | Coalbed Methane |            | Natural Gas Liquids |            |
| Reserves Category  | Gross (Mbbl)         | Net (Mbbl) | Gross (Mbbl) | Gross (MMcf) | Net (MMcf)   | Net (MMcf)   | Net (MMcf)      | Net (MMcf) | Gross (Mbbl)        | Net (Mbbl) |
| <b>Proved</b>  |                      |            |              |              |  |              |                 |            |                     |            |
| Developed Producing  | 42                   | 37         | 0            | 0            | 5,807  | 4,795        | 0               | 0          | 9                   | 8          |
| Developed Non-Producing  | 0                    | 0          | 0            | 0            | 9  | 8            | 0               | 0          | 0                   | 0          |
| Undeveloped  | 33                   | 29         | 0            | 0            | 2,364  | 1,896        | 0               | 0          | 0                   | 0          |
| <b>Total Proved</b>  | <b>75</b>            | <b>67</b>  | <b>0</b>     | <b>0</b>     | <b>8,180</b>   | <b>6,699</b> | <b>0</b>        | <b>0</b>   | <b>9</b>            | <b>8</b>   |
| Probable   | 22                   | 20         | 0            | 0            | 981  | 809          | 0               | 0          | 2                   | 1          |
| <b>Total Proved Plus Probable</b>  | <b>97</b>            | <b>87</b>  | <b>0</b>     | <b>0</b>     | <b>9,161</b>   | <b>7,507</b> | <b>0</b>        | <b>0</b>   | <b>11</b>           | <b>9</b>   |

## 2.2.2 Net Present Value of Future Net Revenue (Constant Prices and Costs)

| <p style="text-align: center;"><b>NI 51-101</b><br/> <b>Summary of Net Present Values of</b><br/> <b>Future Net Revenue</b><br/> <b>as of December 31, 2006</b><br/> <b>Constant Prices and Costs</b></p> |   |                          |                           |                           |                           |  |                          |                           |                           |                           |
|---|---|--------------------------|---------------------------|---------------------------|---------------------------|--|--------------------------|---------------------------|---------------------------|---------------------------|
|   | <b>Net Present Values of Future Net Revenue</b>               |                          |                           |                           |                           |  |                          |                           |                           |                           |
|   | <b>Before Income Taxes</b><br><b>Discounted at (% / Year)</b> |                          |                           |                           |                           | <b>After Income Taxes</b><br><b>Discounted at (% / Year)</b> |                          |                           |                           |                           |
| <b>es Category</b>  | <b>0</b><br><b>(M\$)</b>                                      | <b>5</b><br><b>(M\$)</b> | <b>10</b><br><b>(M\$)</b> | <b>15</b><br><b>(M\$)</b> | <b>20</b><br><b>(M\$)</b> | <b>0</b><br><b>(M\$)</b>                                     | <b>5</b><br><b>(M\$)</b> | <b>10</b><br><b>(M\$)</b> | <b>15</b><br><b>(M\$)</b> | <b>20</b><br><b>(M\$)</b> |
| <b>Proved</b>   |   |                          |                           |                           |                           |  |                          |                           |                           |                           |
| Developed Producing   | 23,457  | 18,647                   | 15,632                    | 13,572                    | 12,074                    | 19,389   | 15,684                   | 13,348                    | 11,738                    | 10,557                    |
| Developed Non-Producing   | 32  | 17                       | 10                        | 6                         | 3                         | 22   | 12                       | 7                         | 4                         | 2                         |
| Undeveloped   | 8,244   | 6,430                    | 5,165                     | 4,245                     | 3,551                     | 5,596  | 4,279                    | 3,360                     | 2,692                     | 2,189                     |
| <b>Total Proved</b>   | <b>31,732</b>   | <b>25,094</b>            | <b>20,807</b>             | <b>17,823</b>             | <b>15,628</b>             | <b>25,007</b>  | <b>19,974</b>            | <b>16,715</b>             | <b>14,434</b>             | <b>12,748</b>             |
| Probable  | 4,767   | 3,724                    | 3,050                     | 2,584                     | 2,245                     | 3,236  | 2,528                    | 2,070                     | 1,754                     | 1,524                     |
| <b>Total Proved Plus Probable</b>   | <b>36,499</b>   | <b>28,819</b>            | <b>23,857</b>             | <b>20,407</b>             | <b>17,873</b>             | <b>28,242</b>  | <b>22,503</b>            | <b>18,785</b>             | <b>16,188</b>             | <b>14,271</b>             |

### Notes:

- 1) NPV of FNR include all resource income:
  - Sale of oil, gas, by-product reserves
  - Processing third party reserves
  - Other income
- 2) Income Taxes
  - Includes all resource income
  - Apply appropriate income tax calculations
  - Include prior tax pools

### 2.2.3 Future Net Revenue Undiscounted (Constant Prices and Costs)

| <b>N1 51-101</b><br><b>Total Future Net Revenue</b><br><b>(Undiscounted)</b><br><b>as of December 31, 2006</b><br><b>Constant Prices and Costs</b> |                          |                            |                                      |  |   |   |                                   |  |
|--|--------------------------|----------------------------|--------------------------------------|--|---|---|-----------------------------------|--|
| <b>Reserves Category</b>   | <b>Revenue<br/>(M\$)</b> | <b>Royalties<br/>(M\$)</b> | <b>Operating<br/>Costs<br/>(M\$)</b> | <b>Development<br/>Costs<br/>(M\$)</b> | <b>Well<br/>Abandon-<br/>ment /<br/>Other<br/>Costs<br/>(M\$)</b> | <b>Future<br/>Net<br/>Revenue<br/>Before<br/>Income<br/>Taxes<br/>(M\$)</b> | <b>Income<br/>Taxes<br/>(M\$)</b> | <b>Future<br/>Net<br/>Revenue<br/>After<br/>Income<br/>Taxes<br/>(M\$)</b> |
| Proved Reserves  | 58,832                   | 11,365                     | 12,751                               | 2,707                                  | 276   | 31,732  | 6,726                             | 25,007   |
| Proved Plus Probable   | 66,621                   | 12,850                     | 14,285                               | 2707                                   | 280   | 36,499  | 8,257                             | 28,242   |

### 2.2.4 By Production Group-Future Net Revenue before Income Tax (Using Constant Prices and Costs – Using a discount rate of 10 percent). (Before Income Tax)

#### **N1 51-101** **Net Present Value of Future Net Revenue** **By Production Group** **As of December 31, 2006** **Constant Prices and Costs**

| <b>Reserves Category</b>         | <b>Production Group</b>   | <b>Future Net Revenue<br/>Before Income<br/>Taxes<br/>(Discounted at<br/>10% / Year)<br/>(M\$)</b> |
|----------------------------------|---|--|
| Proved Reserves                  | <b>Light and Medium Crude Oil (including solution gas and associated by-products)</b> | 1,400  |
|                                  | <b>Heavy Oil (including solution gas and associated by-products)</b>                  | 0  |
|                                  | <b>Natural Gas (including associated by-products)</b>                                 | 19,070   |
|                                  | <b>Coalbed Methane (including associated by-products)</b>                             | 0  |
| Proved Plus<br>Probable Reserves | <b>Light and Medium Crude Oil (including solution gas and associated by-products)</b> | 1,717  |
|                                  | <b>Heavy Oil (including solution gas and associated by-products)</b>                  | 0  |
|                                  | <b>Natural Gas (including associated by-products)</b>                                 | 21,804   |
|                                  | <b>Coalbed Methane (including associated by-products)</b>                             | 0  |



## PART 3 PRICING ASSUMPTIONS

### 3.1 Forecast Prices Used in Estimates

| N1 51-101<br>Summary of Pricing and<br>Inflation Rate Assumptions<br>as of December 31, 2006<br>Forecast Prices and Costs |  |  |                                       |   |  |  |  |   |
|---|--|--|---------------------------------------|---|--|--|--|---|
|   | Oil                                      |  |                                       |   |  |  |  |   |
| Year  | WTI<br>Cushing<br>Oklahoma<br>(\$US/bbl) | Edmonton<br>Par<br>Price<br>40° API<br>(\$Cdn/bbl) | Medium<br>29.3°<br>API<br>(\$Cdn/bbl) | Natural Gas <sup>1</sup><br>AECO Gas<br>Prices<br>(\$Cdn/MMBtu) | Pentanes<br>Plus<br>F.O.B<br>Field Gate<br>(\$Cdn/bbl) | Butanes<br>F.O.B.<br>Gate<br>(\$Cdn/bbl) | Inflation<br>Rate <sup>2</sup><br>(%/Yr) | Exchange<br>Rate <sup>3</sup><br>(\$US/\$Cdn) |
| Historical  |  |  |                                       |   |  |  |  |   |
| 2002  | 26.09                                    | 40.12  | 35.46                                 | 4.04  | 40.80  | 25.39                                    | 2.7                                      | 0.637   |
| 2003  | 31.14                                    | 43.23  | 37.53                                 | 6.66  | 44.16  | 34.55                                    | 2.5                                      | 0.716   |
| 2004  | 41.42                                    | 52.91  | 45.72                                 | 6.87  | 53.91  | 41.37                                    | 2.5                                      | 0.825   |
| 2005  | 56.46                                    | 69.29  | 57.36                                 | 8.58  | 69.13  | 45.20                                    | 1.6                                      | 0.850   |
| 2006  | 66.09                                    | 73.31  | 62.35                                 | 7.16  | 75.03  | 59.32                                    | 2.0                                      | 0.882   |
| Forecast  |  |  |                                       |   |  |  |  |   |
| 2007  | 65.73                                    | 74.10  | 63.72                                 | 7.72  | 75.88  | 55.23                                    | 5.0                                      | 0.870   |
| 2008  | 68.82                                    | 77.62  | 66.75                                 | 8.59  | 79.49  | 57.85                                    | 4.0                                      | 0.870   |
| 2009  | 62.42                                    | 70.25  | 60.41                                 | 7.74  | 71.94  | 52.36                                    | 3.0                                      | 0.870   |
| 2010  | 58.37                                    | 65.56  | 56.38                                 | 7.55  | 67.14  | 48.87                                    | 2.0                                      | 0.870   |
| 2011  | 55.20                                    | 61.90  | 53.24                                 | 7.72  | 63.40  | 46.14                                    | 2.0                                      | 0.870   |
| Thereafter  |  |  |                                       | Various Escalation Rates  |  |  |  |   |

- 1) This summary table identifies benchmark reference pricing schedules that might apply to a *reporting issuer*.
- 2) Inflation rates for forecasting prices and costs.
- 3) Exchange rates used to generate the benchmark reference prices in this table.
- 4) Pricing assumptions were provided by Sproule Associates Limited.

#### Notes:

Product sale prices will reflect these reference prices with further adjustments for quality and transportation to point of sale.

### 3.2 Constant Prices Used in Estimates

**N1 51-101  
Summary of Pricing Assumptions  
as of December 31, 2006  
Constant Prices and Costs**

| Year              | WTI<br>Cushing<br>Oklahoma<br>(\$US/bbl) | Edmonton<br>Par<br>Price<br>40° API<br>(\$Cdn/bbl) | Medium<br>29.3°<br>API<br>(\$Cdn/bbl) | Natural Gas <sup>1</sup><br>AECO Gas<br>Prices<br>(\$Cdn/MMBtu) | Pentanes<br>Plus<br>F.O.B<br>Field Gate<br>(\$Cdn/bbl) | Butanes<br>F.O.B.<br>Gate<br>(\$Cdn/bbl) | Exchange<br>Rate <sup>3</sup><br>(\$US/\$Cdn) |
|-------------------|--|--|---------------------------------------|---|--|--|---|
| <b>Historical</b> |  |  |                                       |   |  |  |   |
| Dec. 31, 2001     | 19.78                                    | 31.15  | 22.41                                 | 3.64  | 29.25  | 16.73                                    | 0.628   |
| Dec. 31, 2002     | 31.23                                    | 49.26  | 41.95                                 | 5.97  | 50.22  | 38.91                                    | 0.634   |
| Dec. 31, 2003     | 32.56                                    | 40.60  | 36.39                                 | 6.88  | 44.18  | 37.73                                    | 0.771   |
| Dec. 31, 2004     | 44.04                                    | 46.51  | 32.10                                 | 6.78  | 51.80  | 39.78                                    | 0.832   |
| Dec. 31, 2005     | 61.04                                    | 68.12  | 52.28                                 | 9.99  | 71.35  | 59.32                                    | 0.860   |
| <b>Forecast</b>   |  |  |                                       |   |  |  |   |
| Dec. 31, 2006     | 61.05                                    | 67.59  | 62.45                                 | 6.13  | 71.51  | 54.00                                    | 0.858   |

- 1) This summary table identifies benchmark reference pricing schedules that might apply to a *reporting issuer*.
- 2) Exchange rates are used to generate the benchmark reference prices in this table.
- 3) Pricing assumptions were provided by Sproule Associates Limited.

**Notes:**

Product sale prices will reflect these reference prices with further adjustments for quality and transportation to point of sale.

**PART 4 RECONCILIATIONS OF CHANGES IN RESERVES AND  
FUTURE NET REVENUE**

**4.1 Reserves Reconciliation**

**N1 51-101  
Reconciliation of Company Net Reserves (After Royalty)  
By Principal Product Type  
as of December 31, 2006  
Forecast Prices and Costs <sup>1</sup>**

|                          | nd Medium Oil           |                           |   | Associated and Non-<br>Associated Gas |                           |   | l Gas Liquids           |                           |   |
|--------------------------|-------------------------|---------------------------|---|---------------------------------------|---------------------------|---|-------------------------|---------------------------|---|
| Factors                  | Net<br>Proved<br>(Mbbl) | Net<br>Probable<br>(Mbbl) | Net<br>Proved<br>Plus<br>Probable<br>(Mbbl) | Net<br>Proved<br>(MMcf)               | Net<br>Probable<br>(MMcf) | Net<br>Proved<br>Plus<br>Probable<br>(MMcf) | Net<br>Proved<br>(Mbbl) | Net<br>Probable<br>(Mbbl) | Net<br>Proved<br>Plus<br>Probable<br>(Mbbl) |
| <b>December 31, 2005</b> | <b>0</b>                | <b>0</b>                  | <b>0</b>                                    | <b>2,241</b>                          | <b>776</b>                | <b>3,017</b>                                | <b>0.5</b>              | <b>0.2</b>                | <b>0.9</b>                                  |
| Extensions               | -                       | -                         | -   | 5,335                                 | 354                       | 6,156                                       | 7.3                     | 1.1                       | 8.4   |
| Improved Recovery        | -                       | -                         | -   | -                                     | -                         | -   | -                       | -                         | -   |
| Technical Revisions      | -                       | -                         | -   | -180                                  | -237                      | -433  | -                       | -                         | -   |
| Discoveries              | 71.0                    | 19.8                      | 90.8  | -                                     | -                         | -   | -                       | -                         | -   |
| Acquisitions             | -                       | -                         | -   | -                                     | -                         | -   | -                       | -                         | -   |
| Dispositions             | -                       | -                         | -   | -                                     | -                         | -   | -                       | -                         | -   |
| Economic Factors         | -                       | -                         | -   | -                                     | -                         | -   | -                       | -                         | -   |
| Production               | -5.2                    | -                         | -5.2  | -708                                  | 0                         | 708   | -0.6                    | -                         | -0.1  |
| <b>December 31, 2006</b> | <b>65.8</b>             | <b>19.8</b>               | <b>85.6</b>                                 | <b>6,688</b>                          | <b>817</b>                | <b>7,505</b>                                | <b>7.6</b>              | <b>1.3</b>                | <b>9.0</b>                                  |

- (1) A reconciliation of *reserves* estimates may be presented using either *constant prices and costs* or *forecast prices and costs* provide that the price and cost case is indicated in the disclosure.
- (2) The numbers may not match due to rounding.
- (3) Technical revision includes reserves reclassification.



## 4.2 Future Net Revenue Reconciliation (Constant Prices & Costs)

For Proved Reserves Only @ 10% Discount of Net Present Value (Before Income Tax)

| <b>NI 51-101<br/>Reconciliation of Changes in<br/>Net Present Values of Future Net Revenue<br/>Discounted at 10% Per Year<br/>Proved Reserves<br/>as of December 31, 2006<br/>Constant Prices and Costs</b> |  |
|---|--|
| <b>Factors</b>  | <b>2006/1/1 -<br/>2006/12/31<br/>M\$</b> |
| Estimated Future Net Revenue Atax at Beginning of Year  | 12,668                                   |
| Sales and Transfers of Oil and Gas Produced, Net of Production Costs and Royalties  | -3,884                                   |
| Net Changed in Prices, Production Costs and Royalties Related to Future Production  | -4,665                                   |
| Changes in Previously Estimated Development Costs Incurred During the Period  | -3,604                                   |
| Changes in Estimated Future Development Costs   | -2,630                                   |
| Extensions and Improved Recovery  | 15,720                                   |
| Discoveries   | 2,134                                    |
| Acquisitions of Reserves  | 0  |
| Dispositions of Reserves  | 0  |
| Net Change Resulting from Revisions in Quantity Estimates   | -530                                     |
| Accretion of Discount   | 984                                      |
| Net Change in Income Taxes for Current Period   | 224                                      |
| Net Change in Income Taxes for Future Forecast  | -1,341                                   |
| Miscellaneous Changes   | 1,640                                    |
| Estimated Future Net Revenue Atax at End of Year  | 16,715                                   |

- Notes: 1 Proved Reserves – Constant Prices  
2 Discounted @ 10%  
3 Before Income Tax Value  
4 After Income Tax Value

### 4.2.1 Additional changes were due to changes used in the Constant Price forecast for December 31, 2005 and December 31, 2006 as follows:

|                          | <b>December 31, 2005 Price (\$)</b> | <b>December 31, 2006 Price (\$)</b> |
|--------------------------|-------------------------------------|-------------------------------------|
| Oil : Edmonton Par       | 68.12/stb                           | 67.59/stb                           |
| Natural Gas (AECO-C)     | 9.99/mcf                            | 6.13/mcf                            |
| Natural Gas By Products: |                                     |                                     |
| Butanes                  | 59.32/stb                           | 54.00/stb                           |
| Pentanes Plus            | 71.25/stb                           | 71.51/stb                           |
| Exchange Rate            | 0.86 u.s./cdn                       | 0.858 u.s./cdn                      |

**4.2.2 The change in future net development costs of proved undeveloped reserves from December 31, 2005 to December 31, 2006 is as a result of increased cost in drilling, completions and facilities**

**4.2.3 The net change in income taxes are due to increases in projected net revenues effective December 31, 2006, versus the projected net reserves effective December 31, 2005 and the increase in capital expenditures on properties during fiscal year 2006.**

**The changes in tax pools are as follows:**

**FEDERAL:**

|                                | COGPE     |           | CDE       |           | CEE       |           | Class 39<br>& 41 | Class 8<br>& 45 | Total      |
|--------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|------------------|-----------------|------------|
|                                | Regular   | Successor | Regular   | Successor | Regular   | Successor |                  |                 |            |
|                                | (\$)      | (\$)      | (\$)      | (\$)      | (\$)      | (\$)      | (\$)             | (\$)            | (\$)       |
| Opening balance per Tax return | 868,504   | 530,023   | 333,806   | 3,193     | 2,906,708 | 0         | 1,920,451        | 29,553          | 6,592,238  |
| Additions for 2006             | 374,691   | 0         | 1,721,735 | 0         | 3,718,385 | 0         | 1,810,806        | 33,162          | 7,658,779  |
| Tax pool available             | 1,243,195 | 530,023   | 2,055,541 | 3,193     | 6,625,093 | 0         | 3,731,257        | 62,715          | 14,251,013 |
| Tax claim rate (%)             | 10%       | 10%       | 30%       | 30%       | 100%      | 100%      | 25%              | 20%<br>45%      |            |
| Claim Available                | 124,320   | 53,002    | 616,662   | 958       | 6,625,093 | 0         | 706,464          | 10,335          | 8,136,834  |
| Current year claim             | 124,320   | 53,002    | 616,662   | 958       | 2,027,418 | 0         | 706,464          | 10,335          | 3,539,155  |
| Closing balance per Tax return | 1,118,876 | 477,021   | 1,488,879 | 2,235     | 4,597,675 | 0         | 3,024,793        | 52,380          | 10,711,859 |

**PART 5 ADDITIONAL INFORMATION RELATING TO RESERVES DATA**

**5.1 Undeveloped Reserves**

**5.1.1 Proved Undeveloped Reserves**

Proved Undeveloped Reserves are those reserves expected to be recovered from known accumulations where a significant expenditure is required to render them capable of production and meet the proved developed or proved developed producing reserves classification. Total net capital expenditures for 2007 are anticipated to be \$1,846,000.

**5.1.2 Probable Undeveloped Reserves**

Probable Undeveloped Reserves are those reserves expected to be recovered from known accumulations where a significant expenditure is required to render them capable of production to meet the proved developed or proved developed producing reserves classification from the current probable undeveloped classification. No capital expenditures for 2007 are anticipated.

## 5.2 Significant Factors or Uncertainties

There are no economic factors or significant uncertainties that affect particular components of the reserves data.

## 5.3 Future Development Costs

### 5.3.1 Development Costs of Future Net Revenue

| Proved Reserves<br>(Constant Prices and Costs) |                   | Proved Reserves<br>(Forecast Prices and Costs) |                   | Proved Plus Probable Reserves<br>(Forecast Prices and Costs) |                   |
|--|-------------------|--|-------------------|--|-------------------|
| Undiscounted                                   | Discount<br>@ 10% | Undiscounted                                   | Discount<br>@ 10% | Undiscounted   | Discount<br>@ 10% |
| \$2,705,000                                    | \$2,631,000       | \$2,705,000                                    | \$2,631,000       | \$2,705,000  | \$2,631,000       |

**Note:** Development costs are all incurred in fiscal year 2006.

### 5.3.2 Development Costs of Future Net Revenue (by year)

#### a) Proved Reserves (Constant Prices and Costs)

|      |             |
|------|-------------|
| 2007 | \$2,705,000 |
| 2008 | 0           |
| 2009 | 0           |
| 2010 | 0           |
| 2011 | 0           |

#### b) Proved Reserves (Forecast Prices and Costs)

|      |             |
|------|-------------|
| 2007 | \$2,705,000 |
| 2008 | 0           |
| 2009 | 0           |
| 2010 | 0           |
| 2011 | 0           |

#### c) Proved Plus Probable Reserves (Forecast Prices and Costs)

|      |             |
|------|-------------|
| 2007 | \$2,705,000 |
| 2008 | 0           |
| 2009 | 0           |
| 2010 | 0           |
| 2011 | 0           |

**Note:** Development costs are funded by cash flow.



## PART 6 OTHER OIL AND GAS INFORMATION

### 6.1 Oil and Gas Properties and Wells

Petro-Reef's two main properties representing 99.7% of its net present value (for proved plus probable reserves using 10% discounted values – before income taxes) are located in Central Alberta.

#### 6.1.1 Producing Versus Non-Producing Reserves

Following are properties to which reserves have been attributed and are capable of producing but which are not producing as of the effective date, the percentage of those reserves to the total reserves, and the percentage of those reserves that are non-producing as of the dates indicated.

##### a) (i) Alexander

##### Total Proved plus Probable Reserves (@ December 31, 2006)

| CRUDE OIL & NATURAL GAS LIQUIDS |            |          | NATURAL GAS * |            |          |
|---------------------------------|------------|----------|---------------|------------|----------|
|                                 | Company    |          |               | Company    |          |
| Gross MBbl                      | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
| 244.6                           | 107.2      | 94.6     | 17,763        | 8,275      | 6,784    |

##### (ii) Proved plus Probable Non-Producing Reserves (@ April 04, 2006)

| CRUDE OIL & NATURAL GAS LIQUIDS            |            |          | NATURAL GAS * |            |          |
|--|------------|----------|---------------|------------|----------|
|  | Company    |          |               | Company    |          |
| Gross MBbl                                 | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
| 0  | 0          | 0        | 2,285         | 929        | 760      |
| Percentage of Total Reserves Non-Producing | 0%         | 0%       |               | 36.3%      | 38.0%    |

##### (iii) Total Proved plus Probable Non-Producing Reserves (@ December 31, 2006)

| CRUDE OIL & NATURAL GAS LIQUIDS            |            |          | NATURAL GAS * |            |          |
|--|------------|----------|---------------|------------|----------|
|  | Company    |          |               | Company    |          |
| Gross MBbl                                 | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
| 128.1                                      | 55.7       | 48.20    | 5,574         | 3,1282     | 2,520    |
| Percentage of Total Reserves Non-Producing | 52.0%      | 51.0%    |               | 37.8%      | 37.1%    |

\* Includes solution gas

##### b) Morinville

##### (i) Total Proved plus Probable Reserves (@ December 31, 2006)

| CRUDE OIL & NATURAL GAS LIQUIDS |            |          | NATURAL GAS * |            |          |
|---------------------------------|------------|----------|---------------|------------|----------|
|                                 | Company    |          |               | Company    |          |
| Gross MBbl                      | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
| 0                               | 0          | 0        | 1,708         | 831        | 682      |

**(ii) Total Proved plus Probable Non-Producing Reserves (@ April 04, 2006)**

| CRUDE OIL & NATURAL GAS LIQUIDS            |            |          | NATURAL GAS * |            |          |
|--|------------|----------|---------------|------------|----------|
|  | Company    |          |               | Company    |          |
| Gross MBbl                                 | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
|  | 0          | 0        | 1,830         | 951        | 756      |
| Percentage of Total Reserves Non-Producing | 0%         | 0%       |               | 82.3%      | 77.2%    |

**(iii) Total Proved plus Probable Non-Producing Reserves (@ December 31, 2006)**

| CRUDE OIL & NATURAL GAS LIQUIDS            |            |          | NATURAL GAS * |            |          |
|--|------------|----------|---------------|------------|----------|
|  | Company    |          |               | Company    |          |
| Gross MBbl                                 | Gross MBbl | Net MBbl | Gross MMCF    | Gross MMCF | Net MMCF |
|  | 0          | 0        | 627           | 207        | 175      |
| Percentage of Total Reserves Non-Producing | 0%         | 0%       |               | 24.9%      | 25.7%    |

\* Includes solution gas

**c) Other Properties**

Other properties represent 0.3% of the total net present value (before income tax) with approximately 95% of those properties producing. The other properties are all non-operated.

### 6.1.2 Producing Versus Non-Producing Oil & Gas Wells:

Following is a list of oil and gas wells (gross and net) which are producing and non-producing (@ December 31, 2006). All the oil and gaswells are in Central Alberta Canada.

#### Production is as of December 31, 2006

|                                      | Oilwells |     | Gaswells |      |
|--------------------------------------|----------|-----|----------|------|
|                                      | Gross    | Net | Gross    | Net  |
| Producing                            | 2.0      | 1.1 | 16       | 6.17 |
| Non-Producing @<br>December 31, 2006 | 0        | 0   | 2        | 0.98 |

**Note:** Only wells which have reserves assigned by the qualified independent reserves evaluator have been reported.

### 6.2 Properties With No Attributed Reserves

#### 6.2.1 Unproved Properties <sup>(1)</sup>

| Location                  | Gross (Acres) | Net (Acres) |
|---------------------------|---------------|-------------|
| Alexander (Qui Barre)     | 3,772.5       | 2,172.2     |
| Morinville                | 4,604.3       | 1,328.0     |
| Total Unproved Properties | 8,376.8       | 3,500.2     |

Note 1: Unproved Properties are those lands which have no reserves assigned by the independent reserves evaluator.

There are no work commitments required for fiscal year 2007.

#### 6.2.2 The net area of unproved property which is expected to expire in fiscal year 2007 is 512.4 acres.

### 6.3 Forward Contracts

The Company is not bound by any agreement (including any transportation agreement) which would preclude it from fully realizing future market prices for oil or gas.

### 6.4 Additional Information Concerning Abandonment and Reclamation Costs.

- Petro-Reef estimates abandonment and reclamation cost based on historical average costs for the area net of salvage value at \$30,000 per well.
- Future net wells for which such costs shall be incurred are:
  - For Wells where reserves are assigned equals 6.963 net wells.
  - For Wells where no reserves are assigned equals 1.7325 net wells.
- Undiscounted cost to the Company = \$181,788 for reclamation and abandonment.
- The qualified independent reserves evaluator has estimated \$131,000 for abandonment and reclamation net to the Company before recovery of equipment or salvage value.
- The company expects to pay approximately \$50,000 in the next three years for reclamation and abandonment.



## 6.5 Tax Horizon

The Company does not expect to be required to pay income taxes for its 2006 financial year. It is anticipated that taxes will become payable for fiscal year 2008 or 2009.

## 6.6 Costs Incurred (for fiscal year 2006)

### 6.6.1 Cost for COGPE, CEE, and CDE (\$)

- a) Property acquisition costs (COGPE) = 374,692
- b) Exploration costs (CEE) = 3,718,385
- c) Development costs (CDE) = 1,721,736
- d) Class 39 & 41 = 1,810,806
- e) Class 8 = 28,839
- f) Class 45 = 4,323
- g) Total = 7,658,781

## 6.7 Exploration and Development Activities

### 6.7.1 Wells for fiscal year 2006

|                   |    |
|-------------------|----|
| Exploration wells | 4  |
| Development wells | 10 |

### 6.7.2 Wells for fiscal year 2006

|           |    |
|-----------|----|
| Gaswells  | 10 |
| Oilwells  | 1  |
| Dry Holes | 3  |

## 6.8 Production Estimates

### 6.8.1 Production estimates for 2007 (based on Company Interest) are:

- a) Using Constant Prices and Costs (Proved only)

|     |       |      |
|-----|-------|------|
| Oil | 8.7   | MBbl |
| Gas | 1,533 | MMCF |
| NGL | 1.0   | MBbl |
  - b) Using Forecast Prices and Costs (Proved only)

|         |     |       |      |
|---------|-----|-------|------|
| Proved: | Oil | 8.7   | MBbl |
|         | Gas | 1,527 | MMCF |
|         | NGL | 1.0   | MBbl |
- Proved Plus Probable:**
- |     |       |      |
|-----|-------|------|
| Oil | 8.8   | MBbl |
| Gas | 1,642 | MMCF |
| NGL | 1.1   | MBbl |

Note: Production estimates are taken from the evaluation by the independent reserves evaluator and in the Companies opinion are extremely conservative as required by N1 51-101.

### 6.8.2 Of the above referenced production 99.7% is represented by two (2) properties:

- a) Morinville
- b) Alexander

## 6.9 Production History for fiscal year 2006

### 2006 PRODUCTION & REVENUE SUMMARY

| Month                 | Production<br>BOE / Day | Production<br>BOE /<br>Month | Price<br>\$/<br>BOE | Royalty<br>Expenses<br>\$/BOE | Gross<br>Revenue<br>\$<br>After<br>Royalties | Operating<br>Expenses<br>\$ | Netback<br>\$/BOE | Cash<br>Flow<br>\$ |
|-----------------------|-------------------------|------------------------------|---------------------|-------------------------------|--|-----------------------------|-------------------|--------------------|
| JAN                   | 605                     | 18,750                       | 54.98               | 17.53                         | 702,593                                      | 142,097                     | 30.04             | 579,496            |
| FEB                   | 595                     | 16,658                       | 46.73               | 12.94                         | 453,190                                      | 140,129                     | 25.79             | 313,062            |
| MAR                   | 584                     | 18,091                       | 42.08               | 11.46                         | 622,579                                      | 106,892                     | 24.35             | 515,687            |
| 3<br>Month<br>Average | 595                     | 17,833                       | 47.93               | 13.98                         | 599,121                                      | 129,706                     | 26.73             | 469,415            |
| APR                   | 539                     | 16,172                       | 43.67               | 11.13                         | 665,976                                      | 108,919                     | 25.46             | 557,057            |
| MAY                   | 530                     | 16,424                       | 36.95               | 9.58                          | 531,286                                      | 135,131                     | 18.53             | 396,155            |
| JUN                   | 531                     | 15,931                       | 39.22               | 8.70                          | 511,334                                      | 1135,586                    | 21.41             | 375,748            |
| 3<br>Month<br>Average | 533                     | 16,176                       | 39.95               | 9.80                          | 569,532                                      | 126,546                     | 21.80             | 442,987            |
| JUL                   | 382                     | 11,831                       | 39.88               | 8.40                          | 405,592                                      | 119,279                     | 22.22             | 286,313            |
| AUG                   | 317                     | 9,816                        | 42.41               | 9.26                          | 409,278                                      | 127,899                     | 21.92             | 281,379            |
| SEP                   | 316                     | 9,485                        | 31.96               | 6.37                          | 230,347                                      | 113,231                     | 13.54             | 117,116            |
| 3<br>Month<br>Average | 338                     | 10,377                       | 38.08               | 8.01                          | 348,405                                      | 120,136                     | 19.23             | 228,269            |
| OCT                   | 291                     | 9,014                        | 37.89               | 6.29                          | 286,465                                      | 131,277                     | 16.09             | 155,187            |
| NOV                   | 380                     | 11,405                       | 49.08               | 8.75                          | 485,089                                      | 116,841                     | 31.03             | 368,248            |
| DEC                   | 393                     | 12,144                       | 44.02               | 10.61                         | 427,163                                      | 125,687                     | 24.75             | 301,476            |
| 3<br>Month<br>Average | 355                     | 10,854                       | 43.66               | 8.55                          | 399,572                                      | 124,602                     | 23.96             | 274,971            |
| Average<br>for 2006   | 454                     | 13,810                       | 42.41               | 10.09                         | 479,158                                      | 125,247                     | 22.92             | 353,910            |
| Total<br>for 2006     | 454                     | 165,721                      | -                   | -                             | 5,749,891                                    | 1,502,968                   | -                 | 4,246,923          |

\* Note: Cash flow on this production and revenue summary is before general and administrative costs, interest expense, and before income tax.

Reference is made to barrels of oil equivalent (BOE). Barrels of oil equivalent may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a BOE conversion ratio for natural gas of 6 Mcf: 1 Bbl has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

**PETRO-REEF RESOURCES LTD.**

**Financial Statements**

**December 31, 2005 and 2006**

## AUDITORS' REPORT

### To the Shareholders of Petro-Reef Resources Ltd.

We have audited the consolidated balance sheets of Petro-Reef Resources Ltd. as at December 31, 2006 and 2005, the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005, the results of its operations and its cash flows for years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, Alberta  
April 24, 2007



**PETRO-REEF RESOURCES LTD.**  
**Balance Sheet**  
**As at December 31, 2006 and 2005**

|   | 2006                 | 2005                 |
|---|----------------------|----------------------|
| <b>ASSETS</b>                                     |                      |                      |
| <b>Current assets</b>                             |                      |                      |
| Cash and cash equivalents                         | \$ -                 | \$ 397,904           |
| Accounts receivable                               | 1,864,015            | 2,142,072            |
| Prepaid expenses and deposits                     | 21,267               | 11,192               |
|   | <u>1,885,282</u>     | <u>2,551,168</u>     |
| <b>Property, plant and equipment (note 3)</b>     | <u>13,171,164</u>    | <u>7,911,121</u>     |
|   | <u>\$ 15,056,446</u> | <u>\$ 10,462,289</u> |
| <b>LIABILITIES</b>                                |                      |                      |
| <b>Current liabilities</b>                        |                      |                      |
| Cheques drawn in excess of bank                   | \$ 1,613             | \$ -                 |
| Bank line of credit (note 4)                      | 375,000              | -                    |
| Amounts due to directors and affiliated companies | 208,679              | 177,822              |
| Accounts payable and accrued charges              | <u>5,525,800</u>     | <u>3,609,757</u>     |
|   | 6,111,092            | 3,787,579            |
| <b>Future income taxes (note 8)</b>               | 634,512              | 426,827              |
| <b>Asset retirement obligation (note 5)</b>       | <u>391,648</u>       | <u>217,915</u>       |
|   | <u>7,137,252</u>     | <u>4,432,321</u>     |
| <b>SHAREHOLDERS' EQUITY</b>                       |                      |                      |
| <b>Share capital (note 6)</b>                     | 7,559,760            | 5,558,614            |
| <b>Warrants (note 6)</b>                          | 606,719              | 820,000              |
| <b>Contributed surplus (note 6)</b>               | 570,609              | 534,308              |
| <b>Deficit</b>                                    | <u>(817,894)</u>     | <u>(882,954)</u>     |
|   | <u>7,919,194</u>     | <u>6,029,968</u>     |
|   | <u>\$ 15,056,446</u> | <u>\$ 10,462,289</u> |

SIGNED ON BEHALF OF THE BOARD  
"Joseph Werner"  
 Director

"Robert N. Maertens-Poole"  
 Chief Financial Officer

**PETRO-REEF RESOURCES LTD.**  
**Statements of Operations and Deficit**  
**For the years ended December 31, 2006 and 2005**

|   | 2006                | 2005                |
|---|---------------------|---------------------|
| <b>Revenue</b>                                    |                     |                     |
| Oil and gas sales, net of royalties and ARTC      | \$ 5,749,891        | \$ 3,224,567        |
| Interest income                                   | 9,723               | 3,427               |
|   | <u>5,759,614</u>    | <u>3,227,994</u>    |
| <b>Expenses</b>                                   |                     |                     |
| Production  | 1,502,968           | 757,703             |
| Depletion and depreciation                        | 2,770,624           | 1,380,232           |
| General and administrative                        | 1,158,160           | 593,896             |
| Accretion expense                                 | 31,786              | 13,265              |
| Loss on settlement of asset retirement obligation | 568                 | 4,291               |
| Interest expense                                  | 22,763              | 44,990              |
|   | <u>5,486,869</u>    | <u>2,794,377</u>    |
| <b>Income before income tax</b>                   | 272,745             | 433,617             |
| <b>Future income taxes</b> (note 8)               | <u>207,685</u>      | <u>184,903</u>      |
| <b>Net income for the year</b>                    | 65,060              | 248,714             |
| <b>Deficit - Beginning of year</b>                | <u>(882,954)</u>    | <u>(1,131,668)</u>  |
| <b>Deficit - End of year</b>                      | <u>\$ (817,894)</u> | <u>\$ (882,954)</u> |
| <b>Basic and diluted income per common share</b>  | <u>\$ 0.00</u>      | <u>\$ 0.01</u>      |

**PETRO-REEF RESOURCES LTD.**  
**Statement of Cash Flows**  
**For the years ended December 31, 2006 and 2005**

|  | 2006               | 2005               |
|--|--------------------|--------------------|
| <b>Cash provided by (used in)</b>                                |                    |                    |
| <b>Operating activities</b>                                      |                    |                    |
| Net income for the year  | \$ 65,060          | \$ 248,714         |
| Items not effecting working capital                              |                    |                    |
| Accretion expense  | 31,786             | 13,265             |
| Depletion and depreciation                                       | 2,770,624          | 1,380,232          |
| Loss on settlement of asset retirement obligation                | 568                | 4,291              |
| Stock based compensation   | 481,709            | 176,308            |
| Future income taxes  | 207,685            | 184,903            |
|  | <u>3,557,432</u>   | <u>2,007,713</u>   |
| Asset retirement expenditures                                    | (1,000)            | (19,520)           |
| Net change in non-cash operating working capital items (note 12) | <u>1,585,925</u>   | <u>198,837</u>     |
|  | <u>5,142,357</u>   | <u>2,187,030</u>   |
| <b>Financial activities</b>                                      |                    |                    |
| Bank line of credit  | 375,000            | (700,000)          |
| Proceeds from share issue  | -                  | 1,575,000          |
| Share issue costs  | (1,500)            | (166,822)          |
| Proceeds from exercise of stock options and warrants             | <u>1,343,957</u>   | <u>79,000</u>      |
|  | <u>1,717,457</u>   | <u>787,178</u>     |
| <b>Investing activities</b>                                      |                    |                    |
| Expenditures on property, plant and equipment                    | (7,888,288)        | (2,374,843)        |
| Net change in non-cash investing working capital items (note 12) | <u>628,957</u>     | <u>210,310</u>     |
|  | <u>(7,259,331)</u> | <u>(2,164,533)</u> |
| <b>(Decrease) increase in cash</b>                               | <b>(399,517)</b>   | <b>809,675</b>     |
| <b>Bank (cheques drawn in excess of bank)</b>                    |                    |                    |
| - Beginning of year  | <u>397,904</u>     | <u>(411,771)</u>   |
| <b>Cheques drawn in excess of bank (bank)</b>                    |                    |                    |
| - End of year  | <u>\$ (1,613)</u>  | <u>\$ 397,904</u>  |
| <b>Supplemental information</b>                                  |                    |                    |
| Interest paid  | <u>\$ 22,763</u>   | <u>\$ 44,990</u>   |

## **1. Accounting policies**

Petro-Reef Resources Ltd. (the "Company") is engaged in the exploration for and production of oil and natural gas in Canada. The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada.

The Company has a working capital deficit of 4,225,810 as at December 31, 2006 and \$1,236,411 as at December 31, 2005. The Company is subject to certain debt covenants pertaining to demand operating facilities (note 3). At December 31, 2006 the Company was not in compliance with the working capital covenant. The working capital deficiency primarily results from accounts payable and accrued liabilities incurred as part of its drilling program. Management is proposing to repay this working capital deficiency through a combination of cash flows and future equity issues (note 12).

Significant accounting policies are summarized as follows:

### **Oil and gas operations**

The Company follows the full cost method of accounting for crude oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent depletion rate.

The Company places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves using forward pricing, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the fair value of proved and probable reserves, and the cost, less any impairment, of unproved properties that contain no probable reserves.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the Company includes the net book value of its oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and excludes the unimpaired cost attributable to unproved properties.

### **Depreciation**

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%. Depreciation of computer equipment is calculated using the declining balance method at an annual rate of 45%. Leasehold improvements are amortized over the useful life of 5 years using the straight-line method.



### **Asset retirement obligation**

The Company records a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

### **Stock options**

The Company has an incentive stock option plan for employees, officers, directors and consultants as described in note 6. The Company records stock based compensation expense using the fair value method. The fair value of an option is calculated at the grant date, and expensed equally over the vesting term of the option. The Company records the cumulative stock based compensation as a contributed surplus. When options are exercised, contributed surplus is reduced and share capital is increased by the amount of accumulated stock based compensation for the exercised option. Any consideration received on the exercise of stock options is credited to share capital.

### **Revenue recognition**

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the company are recognized when title passes from the company to its customers.

### **Income taxes**

The company follows the liability method of accounting for income taxes. Under this method, the company records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantially enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized in income in the period of the change.

### **Earnings per share**

The company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

### **Joint ventures**

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

### **Cash and Cash equivalents**

Cash and cash equivalents consist of all cash on hand and balances with banks, as well as all highly liquid short-term investments. The Company considers all highly liquid short-term investments with original terms to maturity of three months or less to be cash equivalents.

### **Measurement uncertainty**

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

## **2. Property, plant, and equipment**

|                           | <b>December 31, 2006</b> |   |                      |
|---------------------------|--------------------------|---|----------------------|
|                           | <b>Cost</b>              | <b>Accumulated depletion and depreciation</b> | <b>Net</b>           |
| Petroleum and natural gas | \$ 21,659,267            | \$ 8,528,679                                  | \$ 13,130,588        |
| Furniture and fixtures    | 80,275                   | 39,699  | 40,576               |
|                           | <u>\$ 21,739,542</u>     | <u>\$ 8,568,378</u>                           | <u>\$ 13,171,164</u> |

|                           | <b>December 31, 2005</b> |   |                     |
|---------------------------|--------------------------|---|---------------------|
|                           | <b>Cost</b>              | <b>Accumulated depletion and depreciation</b> | <b>Net</b>          |
| Petroleum and natural gas | \$ 13,661,763            | \$ 5,766,284                                  | \$ 7,895,479        |
| Furniture and fixtures    | 47,113                   | 31,471  | 15,642              |
|                           | <u>\$ 13,708,876</u>     | <u>\$ 5,797,755</u>                           | <u>\$ 7,911,121</u> |

No interest or general and administrative expenses were capitalized during the period.

Unproven property costs of \$1,249,477 (2005 – \$390,069) have been excluded from capitalized costs subject to depletion.

The company performed a ceiling test calculation at December 31, 2006 in accordance with the policy described in note 1. The oil and gas future prices used in the calculation were based on the company's January 1, 2007 commodity price forecast which is consistent with the price forecast used by its independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the company. The following table summarizes the benchmark prices used in the ceiling test calculation.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

---

| <b>Year</b>         | <b>WTI Oil<br/>(\$US/bbl)</b> | <b>Foreign<br/>Exchange<br/>rate</b> | <b>Edmonton<br/>Light<br/>(crude oil)<br/>(\$Cdn/bbl)</b> | <b>AECO Gas<br/>(\$Cdn/MMBtu)</b> |
|---------------------|-------------------------------|--------------------------------------|---|-----------------------------------|
| 2007                | 65.73                         | 0.86                                 | 74.10   | 7.72                              |
| 2008                | 68.82                         | 0.86                                 | 77.62   | 8.59                              |
| 2009                | 62.42                         | 0.86                                 | 70.25   | 7.74                              |
| 2010                | 58.37                         | 0.86                                 | 65.56   | 7.55                              |
| 2011                | 55.20                         | 0.86                                 | 61.90   | 7.72                              |
| 2012 – 2017         | 59.20                         | 0.86                                 | 66.41   | 8.19                              |
| Escalate thereafter | 2.0% per year                 |                                      | 2.0% per year   | 2.0% per year                     |

The ceiling test calculation did not result in any impairment write down at December 31, 2006.

### **3. Demand operating facilities**

Facility A is a revolving operating demand loan with a maximum limit of \$3,750,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional \$1,000,000 of financing. Interest is at prime plus 1.25% per annum for Facility A and 1.5% per annum for the Facility B. At December 31, 2006 the balance owing on the current loan was \$375,000 (2005 - \$ NIL).

The facilities are secured by \$5,000,000 floating charge debenture over all the Company's assets with a negative pledge and undertaking to provide fixed charges on the Company's major producing properties at the request of the bank. The facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled for May 2007.

The terms of the Company's bank facility includes certain financial statement covenants. At December 31, 2006, the Company was in violation of the working capital covenant, whereby it must maintain a 1 to 1 working capital ratio (including in working capital the undrawn portion of the facility). The Company's bank has issued a waiver regarding this violation. Management is proposing to repay this working capital deficiency through a combination of cash flows and future equity issues (note 12).

### **4. Asset retirement obligation**

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$391,648 (2005 - \$217,915) as at December 31, 2006 based on a total future liability of \$711,198 (2005 - 389,677) which will be incurred between 2006 and 2021. A credit adjusted risk free rate of 5.36 percent (2005 - 6.08 percent) and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation.



**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

A reconciliation of the asset retirement obligation is provided below:

|                              | 2006              | 2005              |
|------------------------------|-------------------|-------------------|
| Balance, beginning of year   | \$ 217,915        | \$ 155,456        |
| Liabilities incurred in year | 142,379           | 64,423            |
| Liabilities settled in year  | (432)             | (15,229)          |
| Accretion expense            | 31,786            | 13,265            |
| Balance, end of year         | <u>\$ 391,648</u> | <u>\$ 217,915</u> |

**5. Share capital**

**a) Authorized**

Unlimited number of voting Class A common shares

**b) Issued**

**Class A common shares**

|   | 2006              |                     | 2005              |                     |
|---|-------------------|---------------------|-------------------|---------------------|
|   | <u>Shares</u>     | <u>Amount</u>       | <u>Shares</u>     | <u>Amount</u>       |
| Balance, beginning of year                      | 21,438,924        | \$ 5,558,614        | 17,738,937        | \$ 4,772,876        |
| Exercise of options (ii)                        | 1,180,000         | 1,042,909           | 200,000           | 101,060             |
| Exercise of warrants (iii)                      | 1,066,367         | 959,737             | -                 | -                   |
| Unit private placement (i)                      | -                 | -                   | 3,499,987         | 874,995             |
| Share issue costs, (net of \$96,500 of tax) (i) | -                 | (1,500)             | -                 | (190,317)           |
| Balance, end of year                            | <u>23,685,291</u> | <u>\$ 7,559,760</u> | <u>21,438,924</u> | <u>\$ 5,558,614</u> |

(i) During 2005, the Company issued 3,499,987 Units priced at \$0.45. Each unit consisted of one Common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase an additional Common Share at an exercise price of \$0.70 per Common Share until February 17, 2007. The warrants have been ascribed a fair value of \$700,000 using the Black-Scholes pricing model assuming a risk-free interest of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. Sinalta Investments Ltd. was paid a finder's fee of \$100,000, and granted warrants to 500,000 Common Shares at an exercise price of \$0.70 until February 17, 2007. These warrants have been recorded as share issue costs estimated at \$120,000 using the Black-Scholes pricing model assuming a risk-free interest rate of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. All shares were subject to a hold period to January 17, 2006.

(ii) The increase in share capital as a result of the exercise of stock options is comprised of the amount of cash received of \$597,501 and the compensation expensed previously of \$445,408.



**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

(iii) The increase in share capital as a result of the exercise of warrants is comprised of the amount of cash received of \$746,456 and the reclassification to share capital of the ascribed value related to the warrants exercised of \$213,281.

**b) Warrants**

**2006**

|  | <b>Weighted Average<br/>Exercise Price</b> | <b>Number</b>    | <b>Amount</b>     |
|--|--|------------------|-------------------|
| Balance, beginning of year ((note 5(a)(i)) | \$ 0.70                                    | 3,999,987        | \$ 820,000        |
| Exercise of warrants                       | 0.70                                       | (1,066,367)      | (213,281)         |
| Balance, end of year                       | <u>\$ 0.70</u>                             | <u>2,933,620</u> | <u>\$ 606,719</u> |

**2005**

|   | <b>Weighted Average<br/>Exercise Price</b> | <b>Number</b>    | <b>Amount</b>     |
|---|--|------------------|-------------------|
| Balance, beginning of year                        | \$ -                                       | -                | \$ -              |
| Private placement agent warrants ((note 5 (a)(i)) | 0.70                                       | 500,000          | 120,000           |
| Unit private placement ((note 5 (a)(i))           | 0.70                                       | 3,499,987        | 700,000           |
| Balance, end of year                              | <u>\$ 0.70</u>                             | <u>3,999,987</u> | <u>\$ 820,000</u> |

**c) Contributed surplus**

|  | <b>2006</b>       | <b>2005</b>       |
|--|-------------------|-------------------|
| Balance beginning of period                    | \$ 534,308        | \$ 380,060        |
| Compensation recognized in the year            | 481,709           | 176,308           |
| Adjustment for options exercised in the period | (445,408)         | (22,060)          |
| Balance, end of period                         | <u>\$ 570,609</u> | <u>\$ 534,308</u> |

**d) Per share amounts**

Earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the year. A reconciliation of the denominators used in the per share calculation is outlined below:

|   | <b>2006</b>       | <b>2005</b>       |
|---|-------------------|-------------------|
| Basic weighted average common shares    | 22,109,165        | 18,994,641        |
| Effect of dilutive options and warrants | <u>3,304,499</u>  | <u>2,752,516</u>  |
| Diluted weighted average common shares  | <u>25,413,664</u> | <u>21,747,157</u> |

## 6. Stock based compensation

The Company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the Company's stock on the date of grant. Options vest after one year and expire after a maximum period of five years from the date of issue.

A summary of the status of the company's stock option plan as of December 31, 2006 and 2005 and changes during the year are presented below:

|                           | <u>2006</u>              |  | <u>2005</u>              |  |
|---------------------------|--------------------------|--|--------------------------|--|
|                           | <u>Number of Options</u> | <u>Weighted Average Exercise Price</u> | <u>Number of Options</u> | <u>Weighted Average Exercise Price</u> |
| Balance beginning of year | 2,120,000                | \$ 0.50                                | 1,510,000                | \$ 0.49                                |
| Granted                   | 1,040,000                | 1.24                                   | 810,000                  | 0.50                                   |
| Exercised                 | (1,180,000)              | (0.50)                                 | (200,000)                | (0.40)                                 |
| Balance end of year       | <u>1,980,000</u>         | <u>\$ 0.89</u>                         | <u>2,120,000</u>         | <u>\$ 0.50</u>                         |
| Exercisable end of year   | <u>940,000</u>           | <u>\$ 0.50</u>                         | <u>1,310,000</u>         | <u>\$ 0.50</u>                         |

The following table summarizes information about stock options outstanding at December 31, 2006:

|                       | <u>Options outstanding</u> |  | <u>Options exercisable</u> |  |
|-----------------------|----------------------------|--|----------------------------|--|
| <u>Exercise Price</u> | <u>Number outstanding</u>  | <u>Weighted Average Remaining contractual life</u> | <u>Number exercisable</u>  | <u>Weighted Average Remaining contractual life</u> |
| \$ 0.42               | 350,000                    | 1.52   | 350,000                    | 1.52   |
| 0.50                  | 430,000                    | 3.54   | 430,000                    | 3.54   |
| 0.52                  | 10,000                     | 3.65   | 10,000                     | 3.65   |
| 0.70                  | 100,000                    | 2.46   | 100,000                    | 2.46   |
| 0.71                  | 50,000                     | 2.21   | 50,000                     | 2.21   |
| 0.90                  | 40,000                     | 4.87   | -                          | -  |
| 1.05                  | 50,000                     | 4.73   | -                          | -  |
| 1.20                  | 390,000                    | 4.82   | -                          | -  |
| 1.30                  | <u>560,000</u>             | <u>4.47</u>  | <u>-</u>                   | <u>-</u>   |
|                       | <u>1,980,000</u>           | <u>3.70</u>  | <u>940,000</u>             | <u>2.68</u>  |

Compensation cost of \$481,709 (2005 - \$176,308) has been recognized for stock options granted during the year.

The weighted average fair value of each option granted during the year ended December 31, 2006 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

|  | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|
| Stock-based compensation (\$)            | \$481,709   | \$176,308   |
| Fair value of options granted (\$/share) | 0.78        | 0.33        |
| Risk-free interest rate (%)              | 4.02        | 3.40        |
| Expected life (years)                    | 3           | 3           |
| Expected volatility (%)                  | 103         | 102         |
| Expected dividend yield (%)              | -           | -           |

**7. Income taxes**

The following table summarizes the temporary differences which give rise to the future income tax liability at December 31:

|                               | <u>2006</u>       | <u>2005</u>       |
|-------------------------------|-------------------|-------------------|
| Future income tax liabilities |                   |                   |
| Property, plant and equipment | \$ 801,585        | \$ 577,232        |
| Future income tax assets      |                   |                   |
| Asset retirement obligation   | (113,578)         | (73,263)          |
| Share issue costs             | (53,495)          | (77,142)          |
| Balance, end of year          | <u>\$ 634,512</u> | <u>\$ 426,827</u> |

At December 31, 2006, the company has successor tax pools of approximately \$365,399 (2005 - \$365,399) available for deduction from future taxable income. These successor pools have not been recognized for purposes of the future tax calculation due to the uncertainty as to whether sufficient revenue will be realized from the related properties to utilize the pools.

The income tax provision differs from the amount computed by applying the expected income tax rate of 34.49% (2005 - 37.62%) to earnings before taxes. The reasons for this difference are as follows:

|   | <u>2006</u>       | <u>2005</u>       |
|---|-------------------|-------------------|
| Earnings (loss) before taxes                                  | \$ 272,745        | \$ 433,617        |
| Expected tax rate   | 34.49%            | 37.62%            |
| Expected tax expense at combined federal and provincial rates | \$ 94,070         | \$ 163,127        |
| Crown royalties and production taxes                          | 177,259           | 149,550           |
| Alberta royalty tax credit                                    | (44,314)          | (57,519)          |
| Resource allowance  | (119,458)         | (128,209)         |
| Stock based compensation                                      | 166,141           | 66,327            |
| Increase (decrease) in future taxes due to tax rate reduction | (69,139)          | (3,396)           |
| Other   | 3,126             | (4,977)           |
| Balance, end of year  | <u>\$ 207,685</u> | <u>\$ 184,903</u> |



**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

**8. Commitments**

The present office lease agreement expires on September 30, 2011. Future lease payments, excluding operating costs, to the end of the lease term are as follows:

|      |          |
|------|----------|
| 2007 | \$77,577 |
| 2008 | 80,922   |
| 2009 | 84,258   |
| 2010 | 86,762   |
| 2011 | 65,070   |

Annual operating costs are estimated at \$33,370

**9. Financial instruments**

**Fair value**

Financial instruments include bank indebtedness, accounts receivable, and accounts payable and accrued charges. At December 31, 2006, the fair market value of the financial instruments approximated their carrying value due to the short-term maturity of these instruments.

**Credit risk**

Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks.

**Interest rate risk**

The Company is exposed to interest rate cash flow risk to the extent that its bank loans are at a floating rate of interest. The related disclosure regarding these debt instruments is included in note 3 of these financial statements.

**10. Related party transactions**

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the year, the Company purchased engineering services in the amount of \$1,051,073 (2005- \$369,663) from a director of the Company. The Company also purchased professional services in the amount of \$78,086 (2005 - \$26,636) from directors of the Company. Included in accounts payable at December 31, 2006 is 208,679 (2005 - \$177,822), payable to related parties.

|   | <b>2006</b>       | <b>2005</b>       |
|---|-------------------|-------------------|
| Property, plant and equipment   | \$ 1,051,073      | \$ 369,663        |
| Expenses:   |                   |                   |
| Professional services included in general and administrative expenses | 78,086            | 26,631            |
| Accounts payable at end of year                                       | <u>\$ 208,679</u> | <u>\$ 177,822</u> |



**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

**11. Cash flows – supplemental information**

|                                      | <u>2006</u>         | <u>2005</u>       |
|--------------------------------------|---------------------|-------------------|
| Changes in non-cash working capital  |                     |                   |
| Operating Activities:                |                     |                   |
| Accounts receivable                  | \$ 175,127          | \$ (470,221)      |
| Prepaid deposits                     | (10,075)            | (5,120)           |
| Accounts payable and accrued charges | 1,420,873           | 674,178           |
|                                      | <u>1,585,925</u>    | <u>198,837</u>    |
| Investing Activities:                |                     |                   |
| Accounts receivable                  | 102,930             | 161,840           |
| Accounts payable and accrued charges | 526,027             | 48,470            |
|                                      | <u>628,957</u>      | <u>210,310</u>    |
|                                      | <u>\$ 2,214,882</u> | <u>\$ 409,147</u> |

**12. Subsequent events**

The Company entered into a private placement financing arrangement closed on January 19, 2007. The Company issued 4,782,609 Units priced at \$1.15 and offered an Over – Allotment Option that issued an additional 478,261 Units priced at \$1.15. The Over-Allotment Options were exercised on January 17, 2007.

Each Unit consists of one Common Share and one half of one warrant. Each whole warrant entitles the holder to purchase one additional Common Share at an exercise price of \$1.75 per Common Share until July 25, 2008.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. ("Primary") pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a "best efforts" basis, up to a maximum of 1,500,000 common Shares ("Flow Through Shares") at a price of \$2.00 per share on a flow through basis for an aggregate purchase price of \$3,000,000 (\$2,805,000 net of commissions). The Closing Date is expected to be on or about April 13, 2007, or as otherwise agreed by Petro-Reef and Primary.

Petro-Reef has agreed to pay Primary a commission equal to 6.5% of the gross proceeds raised, and to issue broker warrants ("Broker Warrants") to it, entitling Primary to purchase up to that number of common shares of Petro-Reef which is equal to 6.5% of the number of Flow Through Shares issued under the Offering, at an exercise price of \$2.00 per share at any time on or before July 25, 2008. These shares will not carry flow through treatment.

The Flow Through Shares will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Flow Through Shares will be used to fund the continued exploration and development of Petro-Reef's properties. Closing is subject to normal regulatory approvals. The Flow Through Shares will be subject to a four month hold period from the Closing Date.

The financing closed as proposed on April 25, 2007.

